Lending Discrimination and the Community Reinvestment Act

Federal Reserve Bank of Minneapolis

Grade Levels: 9,10,11,12

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Description:

The Resource Packet is divided into seven sections. Sections I and II present writing guidelines and specific contest rules. Sections III, IV and V describe the major issues involved with lending discrimination and CRA. Sections VI and VII offer information on the Federal Reserve System and an extensive glossary and bibliography.

This document may be printed.

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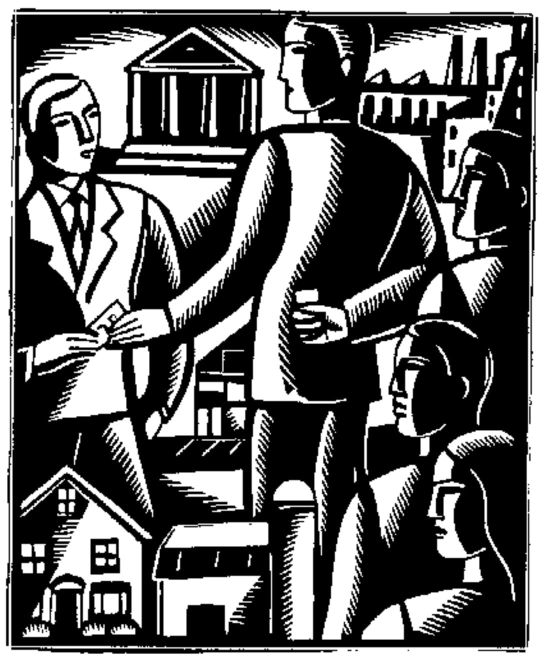
SECTION I -Lending Discrimination and the Community Reinvestment Act



Foreword

Over the past two decades community groups, banks, and their regulators have toiled over the issue of lending discrimination and the effectiveness of the 1977 Community Reinvestment Act(CRA) in search of methods to ensure equitable lending.

There are banking issues of concern to the public in regards to community reinvestment.

Access to credit, for example, is essential for people to buy or improve their homes.

Decisions on who receives loans should be based on factors such as ability to pay and past credit history. However, studies indicate that other factors, such as race and gender, sometimes influence those decisions.

Is the Community Reinvestment Act a necessary and effective tool for eliminating discrimination in lending? How might it be improved?

Lending discrimination and CRA are both urban and rural issues. Although much has been written about CRA's effect on urban areas, the law also has an impact on rural communities.

The Resource Packet is divided into five sections. Sections I, II and III describe the major issues involved with lending discrimination and CRA. Sections IV and V offer information on the Federal Reserve System and an extensive glossary and bibliography.

Although the Resource Packet is a good place to begin your research, it should not be the only source for information. There are a large number of other resources to investigate; many are listed in the packet. Community groups, local banks, and local chambers of commerce are just a few of the places you can contact to learn more about CRA. The bibliography includes most of the major sources available on lending discrimination and CRA.

A wide variety of information can be accessed via computer and modem through "Kimberely," the Minneapolis Fed's electronic database. A brochure explaining how to use Kimberely is included in the Resource Packet mailing. All shaded information in the packet is available on Kimberely. Please use the file name(s) that correspond with information listed in the packet to decrease your computer time.

If you have questions while conducting your research, call me at the Minneapolis Fed. My number is (612) 340-2447.

Rob Grunewald

Lending Discrimination

Although debate exists over the severity of discrimination, it appears to permeate all levels of society. Recent studies show that bank lending is not exempt from at least subtle forms of discrimination. In Minneapolis-St Paul, 88.6 percent of mortgage applications from whites with $40,000 to $60,000 incomes were approved compared to 67.7 percent from blacks, according to the St Paul Pioneer Press. After accounting for over 30 credit-related variables, the Federal Reserve Bank of Boston found that a black or Hispanic applicant is roughly 60 percent more likely to be denied a mortgage loan than a similarly situated white applicant.

"While statistical analysis can highlight inequity, it cannot eliminate it," says Governor Lawrence B. Lindsey, chair of the Federal Reserve Board of Governors' Committee on Consumer and Community Affairs. Lindsey points out that studies like Boston's are statistical and based on averages. Discrimination "is very hard to document by examining specific loan applications," says Lindsey. Whether or not statistical studies definitively prove that lending discrimination exists isn't as important as taking action to ensure unbiased lending now and in the future.

Gary Becker's *The Economics of Discrimination* (1957) brought discrimination into the framework of economic theory. Discrimination occurs in a market where individuals face terms of trade determined by personal characteristics. Some economists argue that competitive markets should drive out firms that discriminate in the long run, because profits fall when firms refuse to deal with persons because of their race or gender. However, despite economic theory, discrimination has long existed. Although legislation prohibits and market incentives discourage discrimination, the problem is likely to persist until personal perceptions are changed.

Lending studies conducted in large cities have opened the issue of lending discrimination to all parts of the country. Students in rural areas can investigate how location, gender and race affect lending decisions. Although many rural communities are ethnically homogeneous, lending issues involving Native Americans and recent immigrants may be pertinent. Bankers in smaller cities and towns provide a vital perspective on CRA since their businesses depend on serving their communities.

Because the essay demands a critical look at lending practices, banks can't escape the limelight. You must use your own judgment to determine the extent of discrimination in lending. However, do look for banks that pro-actively solve lending discrimination problems. They may provide guidance in suggesting reforms to CRA.

Section I Readings:

"For Twin Cities Blacks, Home Loans Hard to Get," St Paul Pioneer Press, May 25, 1993.

Lindsey, Lawrence B. "Breaking Free From Some Outdated Myths," address to a Community Reinvestment Conference, Santa Monica, Calif. Sept. 21, 1992.

For Twin Cities blacks, home loans hard to get

RICHARD MARSHALL / PIONEER PRESS

Tim McWatt, 40, applied to FBS Mortgage last year for a loan to buy a home in Crystal. "They took forever to get back to me, and when I got back to them, I was rejected," he said. McWatt wondered whether race was a factor, but FBS says his credit history was unacceptable.

Rejection rate four times that of whites with similar incomes

RICHARD CHIN, MARTIN J. MOYLAN and JEFFREY C. KUMMER STAFF WRITERS

The Twin Cities area is one of the toughest places in the country for middle-income blacks to get money to buy a house.

They are nearly four times as likely as middle-income whites to be rejected for a home mortgage in the Twin Cities. And they are less likely than blacks in most other metropolitan areas to be approved for a loan, a Pioneer Press analysis of federal lending records has found.

Black home buyers, community activists and real estate agents say racism and discriminatory lending practices are to blame for the high rejection rates and prevent many blacks from achieving the American dream of home ownership.

Mortgage lenders in Minnesota deny they discriminate against blacks seeking home loans.

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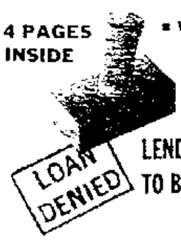


LENDING TO BLACKS

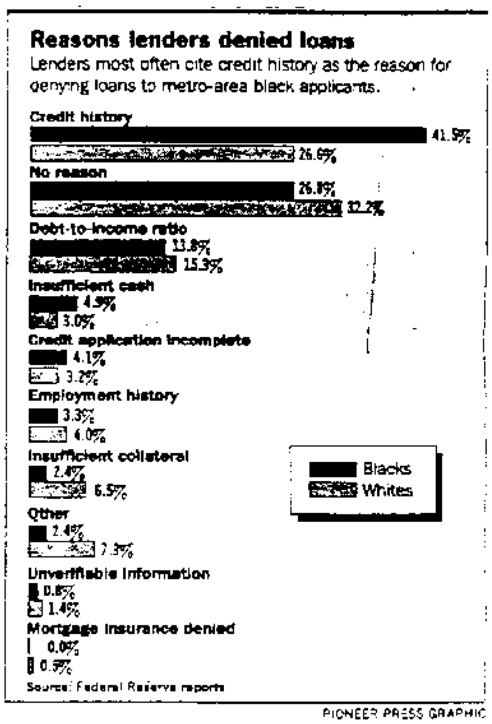
- **What's reason behind denial — race or credit? Page 13A**
- **Rejection rates are just part of the story. Page 14A**
- **Program can assist with home buying. Page 15A**

Lenders say they apply the same standards to all races when considering a loan, and if blacks are rejected at a higher rate, it is because they are less likely to qualify for a mortgage. They also say special programs to provide more loans to low- and moderate-income people and inner-city buyers are making it easier for many black people to get loans.

Still, for whatever reason, home buyers who are black are having a harder time getting a loan than whites, the Pioneer Press study shows.

- The loan approval rate for middle-income blacks, those earning \$40,000 to \$60,000 a year, in the Twin Cities area was the lowest among metropolitan areas in the Midwest and the eighth lowest in the United States.

LOANS continued on 12A ▸



LOANS/Income is only one factor, lenders say

■ Even high-income blacks had trouble getting loans. Blacks earning more than 75,000 a year were turned down for mortgages in the Twin Cities at a rate twice that for whites making less than $20,000.

■ Blacks of all incomes in the Twin Cities were turned down nearly three times as often as whites. Hispanics were turned down nearly twice as often and Asians were rejected about 20 percent more often than whites.

■ The racial makeup of the neighborhood where the home was located seemed to have no bearing on whether a loan would be approved. Blacks attempting to buy homes in white neighborhoods were turned down about as often as those who tried to buy in mostly minority neighborhoods.

The findings are based on a computer-assisted analysis of loan applications for single-family homes in Minnesota in 1991. The records were drawn from recently released loan reports filed by lenders with the Federal Reserve.

Yusef Mgeni. president of the Urban Coalition, was dismayed by the findings.

"It's a stain on the entire community, not just the lending institutions and Realtors," he said. "It says something about the quality of life for all of us."

Although the data shows that blacks get turned down for loans more often than whites with similar incomes, that alone does not prove discrimination.

Lenders say that many other factors besides income are considered before a mortgage is granted.

Blacks could be rejected more often than whites because of more problems with credit history, debt or job stability. those factors are not included in the ending reports and can't be compared by race

But the rejection rates and other federal data still send a clear message: Blacks are unlikely to be homeowners in the Twin Cities area.

Only 31 percent of black householders here are homeowners. the seventh-lowest home ownership rate for blacks among the 50 biggest metropolitan areas in the country, according to the 1990 U.S. Census.

By comparison, 71 percent of white householders in the Twin Cities area are homeowners. the 15th-highest rate of white home ownership among big metropolitan areas.

Lenders and their critics agree that black homebuyers seem to be few and far between in Minnesota. Only five banks. all of them located in the Twin Cities, handled 50 or more home loan applications from blacks.

Blacks of all incomes accounted for 676 of the 41,430 mortgage applications in Minnesota included in the Pioneer Press analysis.

Experts say the inability of a group of people to buy a home has a devastating effect on individuals and neighborhoods. Home ownership is key to the viability of neighborhoods. And buying a house is the most important way most Americans accumulate wealth.

"My children will be richer if I own a house than your children will be if you rent," said Charles Finn, director of the Banking and Community Economic Development Project at the University of Minnesota's Humphrey Institute.

Black homebuyers, black real estate agents and black loan officers say blacks are treated differently by lenders when they try to borrow money to buy a house.

"They more tightly scrutinize African-American loan applicants," said Ken Atwood, a black real estate agent who works with Edina Realty in Minneapolis. "The underwriter is going to feel less comfortable with the African-American loan applicant with respect to any credit problem. They tend to be more comfortable and more understanding with a white applicant."

Cites 'run around'

Tina Luckett believes race played a role in the rejection of her loan application with TCF Mortgage Corp.

Luckett, who is black, sought a $47,400 conventional loan in 1991 for a house in the Frogtown neighborhood of St Paul.

TCF rejected her for past credit problems and for insufficient income. But she later was able to get a $48.370 FHA loan through MidAmerica Bank.

Luckett said she went through a loan counseling program offered by the Association of Community Organizations for Reform Now, which referred her to a TCF loan program tailored to low-income borrowers.

But Luckett said TCF "gave me the run around from the first day I walked in the door."

"When they looked at me as a person, as a single mom, a single black female, trying to buy a house. I think the flags went up right there." she said. "They didn't think I could afford a house. I feel as though they thought I was wasting their time."

Becky Couture, TCF Bank vice president, said Luckett simply did not qualify for a loan when she applied to TCF.

"She was referred to us by ACORN for a HOPE loan, which has much more lenient qualifying guidelines than VA, FHA, or conventional loans," said Couture, referring to TCF's Home Ownership For People's Empowerment program.

"Even with that, she was denied because of a variety of issues she was not yet prepared for." Couture said. "They were primarily credit issues. Even after she was denied. TCF worked with her for several months to take care of those issues. If she was approved by another financial institution, it was because she had taken care of those issues. When she applied to us, they negated our ability to provide her with a loan. She didn't qualify."

Problems with credit

Black loan applicants in Minnesota were most often turned down because of credit history problems, the newspaper's analysis found.

Lenders listed credit problems as the main reason they rejected 41 percent of the black applicants in 1991. as compared with only 27 percent of the whites who were turned down. Black loan applicants on average have less wealth and fewer assets and are more likely to have credit problems than white applicants, experts say.

Those problems account for much of the disparity in success between black and white loan applicants in Boston, according to a recent study by the Federal Reserve Bank of Boston.

But the Boston study also found that lenders have a lot of discretion on how strictly underwriting guidelines are applied. even for loans to be sold on the secondary market. And those lenders "seem more willing to overlook flaws for white applicants than for minority applicants," the study concluded.

So a black loan applicant in the Boston area was still nearly 60 percent more likely to be turned down for a mortgage than a white applicant with the same employment and financial characteristics, according to the study.

While federal banking officials have not done a similar study in Minnesota, they think the same problems are occurring here.

"We assume (what was found in Boston) is true more or less for our market," said Kathleen Balkman Erickson, vice president of the Federal Reserve Bank of Minneapolis. "We assume there is a problem."

The problem, however, can be hard to prove.

Most borrowers, whether white or black, have something in their files that could provide a lender a reason to turn down a mortgage application, according to the Boston study. So it is difficult to say with certainty that any single applicant was rejected because of race rather than for legitimate reasons.

"There's so many different things on how they shut us down, it's almost undetectable," said real estate agent Atwood.

Conditioned response

Some critics of lenders say blacks are less likely to treated fairly by banks and mortgage companies because the majority of loan officers and underwriters in the Twin Cities are white.

"There are some people who have been conditioned to feel that blacks and other minorities are inferior. so when a person of that description walks in, the barriers go up and there is less leniency for taking an application," said Nadine Knibb, head loan counselor with ACORN.

Members of Minnesota's congressional delegation agree that the Pioneer Press findings show that race is a factor in obtaining a home loan.

"It proves that redlining is alive and well." said U.S. Sen. Paul Wellstone. "We have to face up to the fundamental problem of racial discrimination in America and also in Minnesota and the Twin Cities."

U.S. Rep. Bruce Vento, DFL-St Paul, and a member of the House banking committee, agreed.

"I think it does indicate discrimination," he said. "It does indicate problems."

Wellstone and Vento said the data demonstrates the need for legislation to enforce equal access to housing and credit, regardless of race.

Lenders, however, say they do not discriminate against minority homebuyers.

"In my years of time here. I've never seen" discrimination, said Michael Charn-berlain, Norwest Mortgage Inc. senior vice president. "I've never heard that. I've never seen any instances of that."

Experts agree that overt discrimination by lenders based on race is rare.

But blacks still are the victims of the discriminatory effect of banking practices driven by economic pressures and cultural differences.

Banks tend to devote more resources to make loans to whites and suburban borrowers because they feel safer lending money there and believe they can make more money doing it. Finn said.

"One of the reasons why banks do what they do isn't because they're bad," Finn said. "But this is the culture. This is the environment that they do business in."

Some blacks who are good credit risks end up being rejected because they are less likely to fit into a traditional definition of a successful mortgage applicant and get less help from loan officers to qualify, said Atwood.

"It's set up for their profile of the perfect buyer and that person is less likely to be found in the African-American community," Atwood said.

For example, one black underwriter said a black man who sought a loan

SURVEY

▼ CONTINUED FROM 12A

through her had a good income and a stable work history. The man was a good credit risk, she said, but he needed a lot of help to qualify under typical underwriting standards because he was semi-literate and didn't have a bank account or a traditional credit history.

"It just took so much time being a loan officer, and a lot of loan officers just don't have the time to work with someone like that," she said.

Black borrowers on average seek smaller loans than whites, the newspaper's analysis of lending records found. That may work against black borrowers because small loans are less attractive to lenders. They take as much time to process as large loans but represent less money for loan officers who are paid commissions based on loan size.

"They figure the quicker they turn them down, the better off they are," said Don Kelly, a black loan officer with GMAC Mortgage. Kelly said most of the loans he writes are with black buyers who have been rejected at other institutions. "They walked in here as a reject and I'm getting them done."

Excessive scrutiny

Even some middle-class blacks say they have a hard time getting loans.

Doris Jackson, who makes $66,000 a year as a controller for a dry cleaning store chain, said she felt she faced excessive scrutiny when she applied last year for a loan to buy a $159,000 house in Golden Valley for herself and her three children.

Larry Maxwell, a real estate agent with Re/Max who worked with Jackson, said she had a good credit history and money for a 5 percent down payment. He said the loan approval should have been a "slam dunk."

Jackson applied for a loan with Family Mortgage in Shakopee, and was approved. But only after "they just nitpicked every nook and cranny," Maxwell said.

Maxwell said even though Jackson's employer filled out a wage verification form, the mortgage company also asked for a letter from her employer and copies of tax returns. Maxwell said he didn't think a similar white buyer would have been asked for the same information.

"At times you could almost feel they were questioning the authenticity of her income," Maxwell said. "It seemed to me it was hard for them to digest the fact that a black single woman making $60,000 with three kids was making it."

Jackson said she was close to dropping her application. If she had, she would not have been alone in her decision.

Whistleblower's Hot Line

▼ Do you know of something that should be investigated?

Readers who have story tips are urged to call:

The Pioneer Press Whistleblower's Hot Line 222-0080 to leave a taped message, or projects editor Jeffrey Kummer at 228-5450.

PIONEER PRESS GRAPHIC

Black mortgage applicants choose to drop out of the process more often than any other group, the lending records show. About 12 percent of black applicants withdrew their loan applications in 1991, compared with only 7 percent of the white applicants.

Some say those numbers reflect how frustrated many black borrowers become with the process when they try to get a mortgage loan.

"It was kind of insulting and frustrating in the way I was treated," Jackson said. "In a way, I think they were trying to discourage me from getting this loan."

Tom Stienessen, president of Family Mortgage's parent company, The Family Bank in Mankato, said there was a valid reason for all the information that was sought from Jackson. He said blacks are not asked for more information than whites. Many first-time homebuyers feel the documentation process for mortgage applications is excessive, he said.

He noted that the loan officer who handled Jackson's application is black, and his company grants loans and hires employees regardless of race.

"We have a couple black loan officers as well as Jewish loan officers," he said.

Complaints are rare

Despite allegations that blacks are suffering discrimination when they apply for mortgages, there have been few formal complaints or lawsuits against lenders.

Only a handful of complaints charging discrimination in lending in Minnesota have been reported in recent years to agencies such as the state Human Rights Department, the federal Housing and Urban Development Department, the Minneapolis Department of Civil Rights and the St. Paul Human Rights Department.

"People are afraid of taking banks on," said Stephen Cooper, a civil rights lawyer in St. Paul and former state human rights commissioner. "People are used to getting turned down by banks."

What's reason behind denial—race or credit?

LOAN DENIED
LENDING TO BLACKS

Would-be black customers frustrated by a system they say is weighted against them; banks insist that the numbers are proportionate

RICHARD CHIN STAFF WRITER

Timothy McWatt had a lingering suspicion that the color of his skin and not his financial outlook was the reason he was rejected for a home mortgage.

On paper, McWatt is typically middle class. In person, he is also black.

A 40-year-old property claims supervisor for an insurance company where he has worked since 1985, McWatt makes $42,000 a year. He and his wife and two children were living in a home they purchased in North Minneapolis in 1983, but decided last year to sell their home and buy a new house in Crystal.

In late May, McWatt said he filed a preapproval application with FBS Mortgage. He said he went to FBS because he had done all his banking there, and he once worked as a teller at First Bank during college.

But he didn't hear anything about his application until he called FBS in August, when he got an offer on his house.

"They took forever to get back to me and when I got back to them, I was rejected," he said. "They just said they were busy."

He said FBS rejected him for credit problems involving late payments on charge accounts. But he said he had paid off other big loans quickly and had not been late in his house payments. He said the charge accounts were late because his wife had gotten behind in her bookkeeping.

"When I tried to explain that to FBS, they just didn't want to hear. They just looked at it and said sorry," he said. "Given the nature of what they were and how small they were, there was a way around the problem."

McWatt did find a way around the problem by making an application with GMAC Mortgage. He said he provided GMAC with an explanation of the late payments and paid off all of the charge accounts entirely. GMAC approved him for a $92,000 loan in December, and McWatt bought the house in Crystal.

But he still felt bad about his rejection from FBS, and he wondered if his race played a role.

"I'm not quick to run behind that as a barrier," McWatt said. But, he said, "I'm a little suspicious."

Mike Koziak, president of FBS mortgage, said race definitely was not a factor in McWatt's rejection.

FBS did take longer than normal to give McWatt a decision on his application, Koziak said. But he said the company had a large volume of business last summer.

Koziak said McWatt was rejected for legitimate reasons: an unacceptable credit history with eight delinquent payments on his revolving credit accounts within the 12 months prior to his application. The late payments included four more than 30 days late, three more than 60 days late and one more than 90 days late.

Underwriting guidelines call for no more than two delinquencies more than 30 days past due and none more than 60 days within the past year, he said.

Koziak said the number of McWatt's late payments were beyond the amount acceptable even with an explanation.

"It could've been resolved with time," he said. But at the time of application, the credit problems "clearly did not meet our guidelines."

FBS contacted McWatt earlier this year and explained its reasons for turning down his loan after the Pioneer Press questioned the bank about McWatt's concerns.

McWatt said the more detailed explanation, along with the bank's apology for not getting back to him sooner, eased his suspicions.

"I'm not asking for any favors," he said. "I really can't indict them for being totally racially motivated. I'm just not 100 percent sure that I can make that allegation."

But he said FBS still didn't seem eager to have his business since they took so long with an answer on his application.

"The only thing I can say for sure was it was poor service."

A complicated picture

McWatt's story illustrates one aspect of the higher rejection rates blacks have compared to whites when they apply for home mortgages.

It is difficult to tell if the difference is due to discrimination.

A study by the Federal Reserve Bank of Boston has shown that blacks are more likely than whites to have problems with credit history, debt burdens and other financial characteristics. That accounts for some of the gap between the success blacks have getting mortgages compared to whites.

But those problems don't account for all of the difference, according to the study.

Most people who apply for mortgages — black and white — are approved, even though most people have less than perfect credit histories or job records.

Some experts think that lenders are more likely to overlook those problems when the borrower is white.

But the Boston study notes: "Since the bulk of applications contain some flaws, most denials will appear legitimate by some objective standard."

So if discrimination is occurring, it is hard to document.

"I know we sound like nuts saying it's discrimination out there," said Barbara Stokes McCarty, a black real estate agent in St. Paul. "But it is so hidden, so subtle, so difficult to prove."

Rejected four times

Melanie Miles thinks she and her husband, who are black, were held to a higher standard when they sought a mortgage.

Miles, an enforcement officer with the Minnesota Human Rights Department, said she and her husband have good incomes. But they went to four different lenders in 1989 and 1990 before finding one who would give them a loan for a house in St. Paul.

She said she was rejected because of late payments on credit cards and loans. But she felt there was a double standard when she saw a white co-worker with a recent bankruptcy get a mortgage approved.

She also was bothered by questions from a loan officer that seemed to be a commentary on her lifestyle.

"It got real personal," she said. She said the loan officer said " 'maybe we should cut down going out to dinner so much.' "

'No stone unturned'

Some blacks who are approved for mortgages say they have to work harder and endure more scrutiny than comparable white applicants.

Real estate agent Ken Atwood said a black woman he worked with to buy a townhouse in Plymouth in 1990 had to submit a copy of her college degree to United Mortgage before they approved her loan.

Atwood, who has been a real estate agent since 1988, says he has never seen a similar request made of a white applicant.

"The mind-set was, 'What can we do to make the process more difficult?' " Atwood said. "They left no stone unturned in the process. In fact, they went outside the process and picked up a few stones, just in case."

United Mortgage officials, however, said the woman was not treated differently because of her race.

Bruce Robb, United vice president of operations, said copies of college degrees or transcripts are commonly asked of loan applicants in some situations. He said FHA loan guidelines ask applicants to prove they have been in college if they are recent graduates and do not have a long work history.

Of the 44 black mortgage applicants United received in 1991, 38 were approved, six withdrew their applications, but none were rejected.

Lenders admit that applying for a mortgage is a daunting experience. But they say everyone is treated fairly.

"Everyone thinks they're getting picked on by all the requirements out there," said Bert Kroupa, senior vice president of Metropolitan Federal Bank. "We're going to ask the same thing of everyone regardless of color."

Mortgage applications by race

Potential home buyers who are black accounted for 1.6 percent of all Minnesota mortgage loan applicants in 1991, less than the 1.9 percent of total black households.

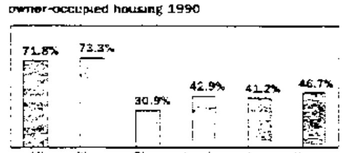
	Mortgage applicants, 1991		
Individual lenders	White percent	Black percent	Other races percent
FBS Mortgage	94.9	2.3	2.8
Investors Bank	95.7	1.4	2.9
Metropolitan Federal Bank	96.5	1.0	2.5
Norwest Mortgage	93.0	3.9	3.0
TCF Mortgage	94.1	2.5	3.4
All Minnesota lenders	**95.4**	**1.6**	**3.0**
All Minnesota households	**95.9**	**1.9**	**2.1**

Source: Federal Reserve reports, 1990 U.S. census

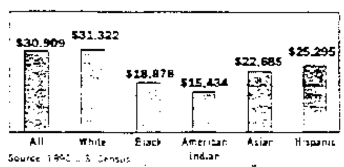
Minnesota homeowners by race

Black residents in Minnesota are the least likely to own their own homes.

▼ Percent of Minnesota households in owner-occupied housing 1990



▼ Median Minnesota household income in 1989



Source: 1990 U.S. Census

PIONEER PRESS GRAPHIC

Five Minnesota lenders' track records

Here are the track records for the five Minnesota lenders who handled at least 50 mortgage loan applications from blacks during 1991.

▼ Lender		▼ Percent rejected	▼ Percent approved	▼ Lender's comments
FBS Mortgage	White	4%	86%	FBS officials said discrimination is not causing the disparity between white and black rejection rates. But they hope the disparity will be reduced as FBS implements new programs to increase lending to the central cities. FBS has pledged to make $50 million in home mortgage loans in St. Paul alone over three years.
	Black	15%	68%	
Investors Savings	White	6%	83%	To give minorities every chance of getting a loan, loan officers may be encouraging black applicants to apply even if they don't appear qualified, Investors officials said. That might result in higher rejection rates, they suggest. The lender has implemented a policy to take a second look at all rejected applicants to see if a loan can be made.
	Black	24%	61%	
Metropolitan Federal Bank	White	2%	93%	Only 52 blacks applied for mortgages with Metropolitan in 1991, too few for a statistically significant conclusion about the higher rejection rate for blacks compared to whites, Metropolitan officials said. Loans standards are applied equally to white and blacks, they said, but the standards result in higher rejection rates for blacks because of income and credit history differences.
	Black	6%	75%	
Norwest	White	3%	92%	Norwest officials said their program to provide loans to low- and moderate-income households has boosted the number of minority applicants and loans provided to minorities. But those efforts also may have resulted in higher rejection rates for blacks compared to whites, they said, because the programs have drawn in more unqualified applicants. Norwest plans to use test shoppers to check if minority loan applicants are treated differently than whites.
	Black	16%	81%	
TCF Mortgage	White	13%	78%	TCF is working with community groups such as ACORN and the Joint Ministry Project to make more loans available to minority and inner-city residents. TCF programs include educational seminars, loan counseling, mortgages with relaxed guidelines and down payment assistance and second reviews of rejected applications. The lender plans to provide $20 million per year in mortgage lending for three years in Minneapolis and St. Paul.
	Black	36%	56%	
All Minnesota mortgage lenders	White	7%	85%	
	Black	18%	69%	

*Numbers won't add up to 100% because some applications are withdrawn or incomplete.
Source: Federal Reserve reports, lenders.

PIONEER PRESS GRAPHIC

How Twin Cities lenders stack up

The Twin Cities metro area had the nation's ninth-greatest disparity between loan approval rates for middle-income white and black applicants in cities with at least 50 black loan applicants in 1991.

Applicants with $40,000 to $60,000 incomes

Cities with greatest disparity	▼ Percent approved applications: White	Black	▼ Disparity* in percentage points	▼ Number of applications: White	Black
Mobile, Ala.	87.7%	57.7%	30.0	835	52
San Francisco, Calif.	83.7	55.6	28.1	1,572	81
Huntsville, Ala.	91.9	67.4	24.5	863	86
Little Rock, Ark.	86.8	63.0	23.8	1,224	119
New Haven, Conn.	88.7	66.0	22.7	1,340	94
Greenville, S.C.	89.4	67.6	21.8	1,686	74
Buffalo, N.Y.	94.1	72.3	21.8	2,596	53
Columbia, S.C.	86.9	65.7	21.2	956	143
Minneapolis-St. Paul	**88.6**	**67.7**	**20.9**	**8,547**	**127**
St. Louis, Mo.	91.1	70.9	20.2	6,832	368
Cities with smallest disparity					
San Diego, Calif.	87.5 %	81.2%	6.3	5,436	234
Bakersfield, Calif.	89.9	83.7	6.2	1,882	98
Chattanooga, Tenn.	89.9	84.3	5.6	963	51
Oklahoma City, Okla.	91.1	86.1	5.0	2,106	79
Tampa-St. Petersburg, Fla.	88.0	83.0	5.0	5,565	200
Albany-Troy, N.Y.	91.8	89.1	2.7	2,343	55
Shreveport, La.	89.8	87.7	2.1	609	65
Knoxville, Tenn.	94.3	95.7	-1.4	2,008	94
Tacoma, Wash.	86.6	90.1	-3.5	2,566	81
Anaheim, Calif.	84.6	91.3	-6.7	5,061	92

*Percentage-point difference between white approval and black approval rates.
Source: Federal Reserve reports

PIONEER PRESS GRAPHIC

How the mortgage study was done

The Pioneer Press reviewed 41,430 applications for home purchase loans reported in 1991 to the Federal Reserve Board by nearly [illegible] Minnesota lending institutions as required by the U.S. Home Mortgage Disclosure Act.

Although the Federal Reserve collected more than 115,[illegible] home loan applications from Minnesota lenders, the Pioneer Press study was limited to new mortgages on owner-occupied homes. Not included were refinancings, home improvement loans or mortgages purchased from another lender.

The newspaper also excluded from the analysis all records containing incomplete information or data that appeared to be erroneous.

The mortgage data was then placed into a computer database, and analyzed according to a number of factors, including lender, race of the applicant, income and location of the property for which the loan was sought.

Where to find home-buying help

Here are some places that provide home-buying counseling and information on special loan programs in Minnesota.

Community and advocacy groups and government organizations

- ACORN. Association of Community Organizations for Reform Now. 642-9639
- Minneapolis Community Development Agency, mortgage programs. 673-5288
- St Paul Ecumenical Alliance of Congregations. 290-9192
- St Paul Home Loan Fund. 228-3105
- St Paul Housing Information Office. 228-3105
- Thompson Associates. 644-2710

Lenders

- American National Bank: Lawana Brown, 229-6541
- First Bank: Lou O'Connor, 962-0092, or Mary French, 641-6762
- Investors Savings. Erin Ryan. 542-3000
- Metropolitan: 928-5300 (Ask for a loan officer).
- Norwest: Call local Norwest Mortgage Office or Community Home Ownership Program. 667-1716
- TCF Mortgage. Loreen Engebretson. 370-2674

Special mortgage programs

An array of programs are available in Minnesota to help people seeking loans. Many lenders also have information on special programs offered by cities and the state.

- **Conventional mortgages**

Available at banks, savings and loans. and mortgage companies.

- Down Dayment: Generally. a minimum of 5 percent to 20 percent of the purchase price is required.
- Debt ratio guidelines: Mortgage payment. Including taxes and insurance, is not to exceed 28 percent of gross monthly income. Total long-term debt payments — the sum of mortgage, credit card, consumer loan, child care, alimony, child support and other obligations generally longer than six months — is not to exceed 36 percent.

- **Federal Housing Administration (FHA) mortgages**

Banks, savings and loans, and mortgage companies can be more flexible with these federally guaranteed loans.

- Down payment: Generally, 2 percent to 3 percent is required. (Minimum buyer investment, which includes closing costs plus down payment, must equal about 5 percent of the purchase price.)
- Debt ratio guidelines: Mortgage payment is not to exceed 29 percent of gross monthly income: total monthly debt payments are not to exceed 41 percent.

- **Community Homebuyers Program**

Buyers must take part in a home ownership education program, which is available at most banks, savings and loans, and mortgage companies.

- Down payment: Five percent minimum. Three percent must come from buyer's money: 2 percent may come from other sources, such as gifts and grants.
- Debt ratio guidelines: Mortgage payment cannot exceed 33 percent of gross monthly income: total long-term debt 41 percent.

- **First Bank: Home Advantage**

Counseling and property inspections are required. Financial aid is available to help with closing costs, down payment and property remodeling or repairs.

- Down payment: Buyer must provide at least a $1.000 investment in the property, either through a down payment or by having equity in the home.
- Debt ratio guidelines: Mortgage payments cannot exceed 31 percent of gross monthly income: total long-term debt, 41 percent.

- **Norwest: Community Home Ownership Program**

This program is designed to encourage home ownership in targeted inner-city neighborhoods of Minneapolis and St Paui. Counseling is mandatory for all down payment loan applications: special underwriting considerations are used. Private mortgage insurance is not required.

- Down payment: Five percent down payment required. Down payment loans as much as $1,500 are available for qualified applicants.
- Debt ratio guidelines: Total long-term debt to income ratio may not exceed 38 percent

- **TCF: HOPE**

Counseling is required. Down payment and closing costs assistance are available. Maximum income for participants is $40.800. (Another TCF program. the Community Reinvestment Initiative, targets families with incomes of $25.500 or less.)

- Down payment: Five percent required. At least 3 percent of that must come from the borrower's own pocket. The rest may be borrowed or received as a gift or grant.
- Debt ratio guidelines: Housing payment cannot exceed 33 percent of monthly gross income: total debt. 38 percent. Consideration is given to individuals with a history of handling a higher housing payment ratio.

* Focuses on providing home buying counseling to St Paul and Minneapolis families in public or Section 8 housing

How much mortgage can you afford?

Federal Housing Administration mortgages are frequently used by first-time homebuyers. Follow these steps to get a sense of the maximum monthly mortgage payment you would be allowed under FHA guidelines:

- **Figuring your maximum monthly payment**

To figure out how much you could pay, read the FHA monthly payment chart as you would a mileage chart. Find your income in the left-hand column and your total monthly fixed obligations for nonhousing costs, such as child care and car loans. across the top. The number where the two columns intersect represents the maximum housing payment for which you can qualify, including principal. interest, taxes and insurance.

For example, a family with a $40.000 annual income and $400 in monthly obligations can qualify for a $967 monthly housing payment.

FHA mortgage monthly payment chart

	Monthly fixed obligations								
Income	$200	$300	$400	$500	$600	$700	$800	$900	$1,000
$15,000	$313	$213	$113	$13	$0	$0	$0	$0	$0
20,000	483	383	283	183	83	0	0	0	0
25,000	604	554	454	354	254	154	54	0	0
30,000	725	725	625	525	425	325	225	125	25
35,000	846	846	796	696	596	496	396	296	196
40,000	967	967	967	867	767	667	567	467	367
45.000	1.088	1.088	1.088	1.038	938	838	738	638	538

Figuring your maximum mortgage loan

To determine how large a mortgage you could qualify for under FHA guidelines. find the closest corresponding principal, interest, taxes and insurance payment in the left-hand column and the current interest rate at the top of the chart. The number where the two columns intersect is the maximum mortgage amount for which you can qualify.
For example. If you could make a monthly payment of $967 and the FHA loan rate were 7.%, you could qualify for a maximum mortgage amount of $106,662.

FHA mortgage calculator chart

Monthly payment	Interest rate 6.5%	7.0%	7.5%	8.0%	8.5%
$350	$42.493	$40.856	$39.296	$37.811	$36.433
400	48.563	46.693	44.910	43.212	41.538
450	54.634	52.529	50.524	48.614	46.842
500	60.704	58.366	56.138	54.015	52.047
550	66.775	64.202	61.751	59.417	57.252
600	72.845	70.039	67.365	64.818	62.457
650	78.915	75.875	72.979	70.220	67.661
700	84.986	81.712	78.593	75.621	72.866
750	91.056	87.549	84.207	81.023	78.071
800	97.127	93.385	89.820	86.424	83.276
850	103.197	99.222	95.434	91.826	88.480
900	107.600	105.058	101.048	97.227	93.685
950	107.600	107.600	106.662	102.629	98.890
1.000	107.600	107.600	112.275	108.030	104.094
1.050	107.600	107.600	107.600	107.600	107.600

* Current mortgage interest rates are regularly published in the Sunday Pioneer Homes Section.
Source: FBS Mortgage

Rejection rates just part of story

A lending institution with a high rate of rejection for black mortgage applicants may in fact be trying hard to attract such applicants

RICHARD CHIN and MARTIN J. MOYLAN
STAFF WRITERS

Federal statistics showing a lender rejects black mortgage applicants at a higher rate than whites might indicate the lender is discriminating against blacks.

Or they might not.

A high rejection rate also might be evidence that the lender is trying hard to lend money to minorities, according to some experts.

That's because lenders who vigorously seek minority and low-income borrowers may bring more unqualified applicants in the door, raising rejection rates for minorities.

Likewise, lenders rejecting few black loan applicants may still be discriminating.

A low rejection rate may mean a lender is not doing much to attract black applicants. Or the lender may be discouraging potential black borrowers from even applying, or making the process so hard that some withdraw their applications before they can be rejected.

Norwest

Of the five lenders that handled 50 or more new mortgage applications from blacks in Minnesota in 1991, Norwest Mortgage had the biggest disparity in rejection rates between blacks and whites, according to the Pioneer Press analysis.

But Norwest executives say that reflects their efforts to attract minority home loan applicants.

About 16 percent of the 154 blacks who sought new home loans from Norwest were rejected, compared with only 3 percent of the 3,658 white applicants, meaning blacks were five times as likely to be rejected as whites.

For all lenders statewide, the rejection rate for blacks was about 18 percent, close to three times the white rejection rate of about 7 percent.

Norwest Mortgage, however, has attracted twice as many new home loan applications from blacks than any other Minnesota lender, records show. As a result, loan applicants at Norwest are more likely to be black than at other big lenders.

While 4 percent of all Norwest mortgage applications in 1991 came from blacks, only 1.6 percent of all mortgage applications statewide came from blacks.

"When you're really pushing out there to get these programs out, you're going to be in front of a lot more buyers," said Norwest Corp. spokeswoman Patrice Vick. "We're the biggest minority lender. If we have a higher rejection rate, that's bound to come with the territory."

Norwest executives said they have provided more than $28 million in mortgages to low- and moderate-income buyers in the last three years in a special program designed to provide financing in inner-city neighborhoods.

As a result, the number of home loan applications received by Norwest from low-income minorities increased 52 percent from 1990 to 1991, while rejection rates dropped from 30.6 percent to 17.2 percent, according to Norwest.

Michael Chamberlain, senior vice president at Norwest, said his company will do its own testing for discrimination in mortgage lending. He said Norwest plans to hire an outside agency to send test buyers of different races to make loan applications at Norwest to see if they are treated differently.

"We take a lot of pain and precaution to make sure that (discrimination) doesn't happen," said Norwest Bank Minnesota regional president James Gosser.

TCF

TCF Mortgage executives say their outreach efforts have increased the number of applications from low-income and minority buyers. But they say those efforts also have increased their rejection rates.

TCF rejected about 36 percent of its black mortgage applicants in 1991, close to three times the white rejection rate of 13 percent. Both the white and black rejection rates at TCF were higher than at the other big institutions in the state.

Becky Couture, vice president at TCF Bank, said conservative underwriting standards at TCF have kept rejection rates high.

But she said TCF's efforts to help more low-income and inner-city loan applicants also have pushed up rejection rates.

Programs developed by TCF with the help of community groups such as ACORN and the Join Ministry Project offer potential borrowers educational seminars and loan counseling, mortgages with relaxed underwriting guidelines and down payment and closing-cost assistance.

TCF does better than average at attracting black loan applicants. About 2.5 percent of TCF loan applicants in 1991 were black, compared with the 1.6 percent rate for all mortgage lenders in the state.

Metropolitan Federal

Among the bigger lenders in the state, Metropolitan Federal Bank had one of the lowest percentage of black applicants. Only 1 percent of Metropolitan's home loan applicants in 1991 were black.

Metropolitan rejected just 6 percent of those applicants, the lowest rejection rate for blacks among the five institutions that took the most applications from blacks. But Metropolitan also had the lowest rejection rate for whites, at nearly 2 percent.

As a result, blacks were still about four times as likely as whites to get rejected for a loan at Metropolitan.

Bern Kroupa, Metropolitan senior vice president, said the 52 black mortgage applications received by Metropolitan in 1991 are too few to make any statistically significant conclusions about the disparity in rejection rates between blacks and whites.

He said the company is seeking to increase the number of central city and minority applicants it receives by getting involved in special loan programs being developed by ACORN and the Federal National Mortgage Association, one of the large, government-sponsored, mortgage-buying agencies.

"We want loans. We want them from all applicants," Kroupa said. "There's certainly not anything we're overlooking that I can think of."

In general, rejection rates are low at Metropolitan because the company encourages potential borrowers to go through a pre-qualifying program, Kroupa said.

FBS

Black home mortgage applicants at both Investors Bank and FBS Mortgage were rejected about four times as often as whites in 1991.

About 15 percent of black applicants were rejected at FBS, compared with 4 percent of white applicants, records showed. About 2.3 percent of FBS mortgage applicants in 1991 were black.

At Investors, about 24 percent of bank's black applicants were rejected, compared with about 6 percent of its white applicants. About 1.4 percent of Investors mortgage applicants in 1991 were black.

Banking regulators to probe lending bias

MARTIN J. MOYLAN STAFF WRITER

Federal banking regulators vow they're going to take a closer look at lenders' mortgage applications to root out the subtle — and hard to prove — discrimination that keeps many minorities from getting home loans.

"For some time, we have suspected that discrimination accounted for at least some of the difference in home loan approval rates for minorities and nonminorities," Stephen Steinbrink, the former acting head of the Office of the Comptroller of the Currency, told federal banking regulators last month. "But our examination procedures were inadequate to confirm our suspicions. ... That will no longer be the case."

Steinbrink said the comptroller's office, which oversees federally chartered banks, will now compare loan files of minority applicants who were denied loans with the files of whites whose loans were approved.

By doing that, the comptroller's office expects to determine if minority and nonminority applicants with similar qualifications get equal treatment — such as whether lenders are willing to offer special assistance or stretch loan guidelines to make a deal work, regardless of the borrower's race.

"We believe that it is at the point where loan officers must exercise judgment or offer assistance that discrimination enters into the application process," Steinbrink said.

Other federal agencies are on the same track.

In February, John LaWare, a Federal Reserve governor, said the Justice Department, using computerized loan data from 1990 and 1991, had flagged 200 institutions with wide discrepancies in loan approval rates between whites, blacks and Hispanics.

Federal regulators will take a closer look at those lenders and single out the ones with the worst records, he said. The Justice Department then will pick institutions for full-scale investigations of possible discrimination.

Lenders, of course, want to find any apparent discrimination within their organizations before regulators do.

Locally, a number of lenders are taking a closer look at how they treat minorities. Investors Savings, TCF and Norwest take second, and sometimes third, looks at rejected minority applicants to see if there may be some way to make loans to them. Norwest and First Bank have put many employees through sensitivity and diversity training intended to combat any overt or covert racial or cultural biases.

Norwest also plans to hire an outside agency to send test buyers of different races into its mortgage offices to determine whether they get equal treatment.

Rejection rates higher outstate

Tough as it may be for black home buyers to get a loan in the Twin Cities, it is even more difficult for blacks outstate who try for mortgages.

Outstate blacks of all incomes were turned down five times as often as whites, as compared with three times more often in the Twin Cities, according to the federal loan data.

While outstate banks showed slightly bigger rejection rates among applicants of all races when compared with Twin Cities lenders, they were far more choosy when blacks were the borrowers, records show.

Outstate banks rejected 11 of the 30 applications they received from blacks of all incomes in 1991, or about 36 percent. By comparison, those same lenders turned down just 7 percent of the loans sought by whites.

Programs can assist with home buying

LOAN DENIED
LENDING TO BLACKS

MARTIN J. MOYLAN STAFF WRITER

Liz Adams didn't lack the income, credit and work history, or savings needed to get into a house. But she was missing something just as important — knowledge.

She didn't know the first thing about buying a home.

"I didn't know how much money I need for a down payment, what my credit situation needed to be like, how long I had to be on my job, how much money I had to make," says Adams, who is black. "I needed to know everything from start to finish."

Wanting all her ducks in a row when she went after a loan, she took home buyer education classes at the nonprofit Northside Neighborhood Housing Services in Minneapolis. After completing them, she was referred to First Bank for a mortgage.

In about a month, she had a loan for a three-bedroom house in North Minneapolis. Her loan came through a special First Bank program — Home Advantage — that allows down payments of as little as $1,000 and permits buyers to spend as much as 31 percent of their gross monthly income on mortgage payments.

Her case is but one example of how lenders and neighborhood groups have begun working together to get more low-income and racial minorities into homes of their own through programs that offer more flexible lending guidelines, buyer counseling and other kinds of assistance.

To help first-time home buyers, Norwest Mortgage, TCF and First Bank provide counseling in-house or through community groups like the Association of Community Organizations for Reform Now, also known as ACORN, and the St. Paul Ecumenical Alliance of Congregations. The three lenders have also developed in-house mortgage programs that feature relaxed income and down payment guidelines and provide closing-cost assistance.

Such programs are usually available to low-income buyers regardless of race. But because minorities generally have less money than whites, lenders think the programs will mean more loans for people of color.

Norwest Bank Minnesota says it has provided more than $25 million in mortgages to low- to moderate-income home buyers in the first three years of its Community Home Ownership Program. In 1992, the bank made 253 CHOP mortgage loans, totaling $12.8 million, in targeted areas of Minneapolis and St. Paul.

Largely because of CHOP, Norwest has seen a substantial increase in the number of mortgage applications received from Twin Cities minorities earning 80 percent or less of the area median income. Those applications rose from 180 in 1990 to 273 in 1991. During the same period, denials for that group decreased from 30.6 percent to 17.2 percent, Norwest says.

One TCF program calls for the thrift to provide $20 million a year in mortgage lending for three years in Minneapolis and St. Paul. In 1991, the first year of an agreement with ACORN and the Joint Ministry Project, TCF originated $37.6 million in home loans in the Twin Cities, of which $23.8 million was in low- and moderate-income census tracts.

First Bank has vowed to make $50 million in home mortgage loans in St. Paul alone over three years. Some of the loans would be made through its Home Advantage program, with its lower down payment requirement, higher debt ratio guidelines and financial assistance for closing costs, down payments and property remodeling or repairs.

Mike Koziak, head of First Bank's mortgage division, says only about $2 million of the promised $50 million has been loaned. But he's confident the amount will rise fast as First Bank works with more community groups and word about the program spreads.

Relaxed guideline mortgage programs developed by lenders and agencies like the Federal National Mortgage Association (Fannie Mae) and Federal Housing Administration can make homeowners out of many people who think they'll be renters forever. Adams found house payments to be much cheaper than rent. The apartments she has lived in rented for $450 to $600 a month. Her monthly house payments — less than $400 a month — represent a substantial savings.


Knibb

With help from various home owne ship assistance funds and flexible mor gage programs, people with househo incomes of $20,000 — and sometime less — can buy a home, providing the have good credit and stable employmen says Lowell Yost, acting director of S Paul's Housing Information Office.

Home owner counseling is crucial any effort to expand home ownersh among low-income folks, says Nadu Knibb, ACORN's head loan counselor.

At ACORN, prospective home owne get lessons on budgeting, home selecti and inspection, avoiding foreclosure, a home maintenance.

"We give them the common sense b sic information that they need to know Knibb says. "We tell them there are fo basic things they have to look at — t plumbing, electrical and heating systen and, of course, the foundation and roof. those things are not up to par ... th you walk away."

In the past 18 months, 121 people cou seled by ACORN have bought home Thirty-eight percent were black. Overa 48 percent were minority group mem bers, compared with a minority popul tion of about 9.4 percent for the Tw Cities. Seventy-three percent of the app cants were women.

The home buyers assisted by ACOR made $15,000 to $20,000 a year and pa an average of $46,000 for their homes.

So far, none has defaulted on a loan been more than 30 days late with a pa ment. "I think that speaks to the effe tiveness of the loan counseling sem nars," Knibb says.

Adams has the most concrete eviden of the value of such counseling — t two-story three-bedroom house. Built 1925, it has hardwood floors and o woodwork. But best of all, the hous which she shares with two brothers a her niece, is hers.

"The money I'm putting out eve month is building equity that will mine," says Adams, accounting manag for Freeport West Inc., a nonprofit age cy that tries to keep troubled famil together.

Adams senses people care about h neighborhood and she wants to see mo renters transformed into homeowners build on that concern.

"There's more commitment to a neig borhood when people own property in i she says.

Breaking Free From Some Outdated Myths
Address by
Lawrence B. Lindsey
to
A Community Reinvestment Conference
Sponsored by
The Federal Reserve Bank of San Francisco
and
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September 21, 1992

Breaking Free From Some Outdated Myths

Thank you. It's a pleasure to be here in this beautiful setting. We all know from recent events and from our discussions here today that life is not necessarily as beautiful as our current surroundings.

Shortly after joining the Board last November, Chairman Greenspan asked me to chair the Fed's Committee on Consumer and Community Affairs. I must admit that I had no particular knowledge or expertise in that area when he appointed me. But, as someone who has spent many years in education, I thought that this was an opportunity to learn something new. At the very least, my lack of prior experience permitted me to go into this area with an open mind. Over the intervening months I've traveled throughout this country, seen first hand what's working in our cities and what isn't, and met extensively with both community groups and bankers. As an experience in what's really happening, I must admit that these last 10 months have easily beaten the years I spent in graduate school.

It was during this same period that a great deal of attention was focused on discrimination in mortgage lending. Late last year, the nation's bank regulatory agencies released the first detailed information on the relationship between race, income, and mortgage lending, known as HMDA data. The volume of information processed was staggering, even to an old micro-data empiricist like myself. Stacked in computer printout, the data on the HMDA disclosures would nearly reach to the top of the Washington Monument.

Later this fall we will be releasing the HMDA data for 1991. We will also be releasing, through the Federal Reserve Bank of Boston, an extensive study of mortgage lending in that city that was conducted by examining 4100 actual loan files from 131 banks, savings institutions, and mortgage companies. Other regulators, notably the New York State Commissioner of Banking and the U.S. Department of Justice have been involved in similar reviews.

My comments today reflect both what I have learned from my travels, and what can be gleaned from some of these other efforts. By no means do I claim to have a monopoly on the truth. The subject we are dealing with is enormously complicated as well as being extremely sensitive, and others may draw different conclusions. But I am not going to let either complexity or sensitivity stand in the way of candor. Finding solutions to our problems is far more important.

Recently, when testifying before the U.S. Commission on Civil Rights, I heard an outstanding summary of this view by its Chairman, Arthur A. Fletcher He said that it may be too much to ask us to change our deeply held, and often unconscious, prejudices, but it is not too much to ask to have them stop controlling our behavior. To that end, I believe that our current beliefs and behavior are tied to a series of outdated myths that hold us back from making progress in providing economic opportunity for all Americans. Unfortunately, our nation's media and opinion leaders are doing little to dispel these myths, and may actually be reinforcing them. When these myths are exposed for what they are, we will all find it in our interest to stop letting them control our behavior.

The first myth that I would like to dispel is the view held by some that there is no racially based problem in the area of mortgage lending. There is a problem and it is one which we absolutely must address.

Having said that, two important qualifications are in order. First, it does appear that the HMDA data exaggerate the extent to which approval rates differ for racial reasons. When economic factors other than income are incorporated into the analysis of HMDA data, the disparity between black and white approval rates is reduced. However, that does not in any way diminish the qualitative conclusion that race based differences exist and that they must be eliminated.

Second, the evidence of race-based differences in loan approvals is overwhelmingly of a statistical nature, based on racial averages, and is very hard to document by examining specific loan applications, such as during the bank examination process. Accepting this fact is difficult for those who seek simple, straight forward explanations for the racial disparities. It's always easier when there's a smoking gun and an identifiable culprit.

However, the reality in this case is not so simple. Understanding the limitations of statistical analysis may be key to solving the underlying problem and establishing truly equal credit opportunities for all Americans. While statistical analysis can highlight inequity, it cannot eliminate it. That must be done on an individual basis, on the front lines, between the applicant and the loan officer.

Let me clarify what appears to be going on. It appears from the available evidence that both blacks and whites who meet all of the criteria which banks have laid down for loan approvals are approved and those who clearly do not meet the criteria and are obviously bad credit risks are rejected. What is left is a sizable middle group, which comprises a majority of mortgage applicants of both races. All of these applicants could be rejected for a valid reason: level of income, job tenure, debt to income ratios, or a variety of other factors. However, with some level of effort and explanation, many of these applicants can, and often are, approved.

This makes identification of race based decision making quite difficult during the examination process. In the case of rejected applicants, both black or white, there is almost always a non-racial explanation for the rejection. This finding was best highlighted in a recent report by the New York State Banking Commission, entitled "Are Mortgage Lending Policies Discriminatory — A Study of 10 Savings Banks".

From this middle group some individuals of both races are accepted, but on average whites in this middle group are more likely to be accepted than blacks. Acceptance of marginal applicants generally requires a detailed explanation of any mitigating circumstances for why the applicant should be accepted. This seems to have led to what I will refer to as the "thicker file" phenomenon. There is fairly solid, albeit anecdotal, evidence that many marginal white applicants have physically thicker loan application files than marginal black applicants. This extra paper may very well represent the documentation of mitigating circumstances or evidence countering the putative reason to reject the applicant.

There have been a number of theories advanced for this "thicker file" phenomenon. It might be that white applicants have had, on average, more prior exposure to the credit process and therefore come better prepared. It might also be that loan officers spend greater time, on average, with white applicants, probing more deeply into whether they might have evidence to offset the reason that might otherwise lead to rejection. I would term this "coaching".

If "coaching" or the "thicker file" phenomenon represents part of the problem, then one solution to racial based disparities may well be found in improving the information flow that takes place in the credit underwriting process. In other words, give each and every applicant the opportunity for a "thicker file". This can be done by providing more information to applicants so that they are better prepared in advance of the application procedure to answer any questions about their qualifications. If loan officers are going to be coaches, then they should be careful to coach everyone, and not a few favored applicants. It certainly involves sensitizing all of those in the loan application process to the problems which exiSt But let us make no mistake: race-based disparities in mortgage lending do exist and they are totally unacceptable.

The second myth I would like to address involves the economic status of blacks, and particularly the change in that status in the past decade. This is a very important subject to address because both banking in general, and mortgage lending in particular, are profit driven businesses. Lending will take place where there is money to be made, or more precisely, where it is perceived that there is money to be made. Unfortunately, there is a widespread myth, reinforced by the media, that the great majority of blacks live in poverty, and that little progress has been made recently in ending that situation.

The facts could not be more different. During the 1980s tremendous gains were made by the great majority of black families. Between 1981 and 1990, median black family income rose 12.3 percent after controlling for inflation. By contrast, the income for the median white family rose only 9.2 percent. Black income growth particularly outpaced white income growth among those families most likely to be first time homebuyers. After controlling for family size, the top quintile of black families saw their real income rise 28 percent during the 1980s. The second quintile of black families enjoyed a 19 percent gain. The proportion of black families living in suburban counties rose by a third and the proportion of black families earning real incomes over $50,000 rose by 42 percent. Such individuals are the natural applicants for mortgage loans.

Not only that, but the situation is likely to get better in the next generation due to significant gains in black educational achievement. During the 1980s, the SAT scores of black children rose 23 points in math and 20 points on the verbal test, compared with essentially stagnant scores for white students. The black dropout rate from high school fell from 18 percent to 13 percent over the same period. These facts augur well for future black income gains.

It is not just in the area of mortgage lending that minorities represent an underserved market. The Wall Street Journal called the 1980s the decade of minority capitalism. Between 1983 and 1987 there was a 50 percent increase in the number of businesses owned by African Americans and 81 percent increase in the number of Hispanic owned businesses. More black owned businesses were created from 1982 to 1987 than in any other comparable five year period in our history. I might also add that more Asian Americans and women went into business during this period than at any other time. These businesses not only need banks for capital, they also need them for financial expertise.

Increased awareness of the opportunities for minority lending means dispelling the myths about the lack of economic importance of minority communities. One of the places that I have seen where this myth was most successfully destroyed was in Dallas. The South Dallas - Fair Park area of that city is overwhelmingly black and generally low income, comprising roughly 80,000 residents. Prior to last year, no bank branch had operated in the area for at least two decades. Last month, NationsBank celebrated the first anniversary of its Fair Park branch. The branch had exceeded its first year target for consumer loans by 40 percent, and was one of the top 3 performing branches in the entire state of Texas. I might add that Bank One has also opened a branch four blocks away and NationsBank is planning to duplicate this success by opening similar branches in other low income neighborhoods in Texas. Where myths are destroyed, markets will work.

The third myth I would like to consider is that sweeping national solutions will solve the problems we face. Congress has recently been quite disposed to a highly prescriptive approach to regulating the banking industry. In the case of racial disparities, such an approach may seem attractive. Racial discrimination tears at the very fabric of our national ideal. While further legislation would certainly be well intentioned, I am not at all convinced that one-size-fits-all national rules represent the best approach to increased minority lending, or to improved credit availability of any sort. I am repeatedly struck as I travel around the country about that old saw — the Law of Unintended Consequences. In too many instances it is well intentioned government policies that are exacerbating the problems we face.

Consider for example, the legislation and organization which created the secondary mortgage market in this country. Fannie Mae has, by most accounts, been quite successful at its main mission: to provide liquidity to the mortgage market by creating easily traded mortgage backed financial instruments. But a price has been paid for such liquidity. Increasingly, banks have moved to standardized lending practices as they have seen their mortgage business evolve into that of a broker, rather than a lender. It is no longer crucial that banks know their customer, but rather that their customers fit a predetermined profile. Credit evaluation is based increasingly on quantitative criteria, rather than qualitative judgments.

If you're a one-size-fits-all customer, you have probably benefited greatly from this approach. If you are one of those people who is different from the norm, your need for that coaching I discussed earlier, rises dramatically. Let me say that Fannie Mae recognizes this problem and is striving to make sure its guidelines take a broader array of applicants into account. For example, seasonal part-time income is now considered regular income if the person has earned that money at least two seasons in a row, child support payments are now counted, maintenance and zoning standards for property have been liberalized, and credit history standards have been modified in a number of ways. A recent Congressional testimony by Jim Johnson, Fannie Mae's Chairman, lists 20 such changes in the last 5 years. Indeed, the very quantity and detailed nature of these changes is proof of how complex the lending decision has become.

Recently, the Federal regulatory agencies, prompted by Congressional action in last year's banking bill, considered establishing maximum loan-to-value ratios for single family housing lending. I strongly opposed such a move because it would further exacerbate the difficulty of obtaining a loan for individuals who do not meet the normal criteria. I was particularly concerned about the impact of this on mortgage lending to low and moderate income families who have limited funds to cover closing costs, let alone provide a major down payment. In fact, the fewer such rules we have, the easier it will be for non-traditional borrowers, who are often members of minority groups, to obtain credit.

As I've traveled around the country I've seen numerous other examples of well intentioned government policies that are making access to housing more difficult, particularly for minority groups. For example, consider the cap on the size of loans eligible for FHA insurance. As a result of these limits, FHA loans are virtually unavailable in New York City, where the overwhelming majority of housing costs more than the limits allow. Nearly every Neighborhood Housing Services coordinator spoke with felt limited by the Davis-Bacon legislation which drives up the cost of housing construction and limits job opportunities for inner city residents. In city after city, rules regarding the taxes owed on vacant land or on abandoned buildings are inhibiting the development of low and moderate income housing and the development of communities.

It is human nature to place the blame for problems on others. Some might say that for elected politicians and other decision makers it is a requirement for the job. Today we are here primarily to consider what financial institutions might do to improve minority home ownership. But those of us who are here from government must go back and consider our own policies. Government, like the medical profession, should follow the first principle of the Hippocratic Oath: above all do no harm.

The final area of mythology and ignorance which I would like to address has to do with credit itself. The level of ignorance which exists about credit is truly remarkable, given the widespread nature of its use. Nor is it an easy area to master. Highly educated people often know little or nothing about the factors used to make credit decisions.

Consider for example, the case of Jacqueline Mixon of South Dallas, who received a home improvement loan after numerous rejections. Mrs. Mixon is a college graduate and supervises 200 people. Yet she admitted that she and her husband were unfamiliar with the loan process and that this might have been a factor in their previous rejections.

The great myth that may exist among bankers is that their customers have some way of knowing their bank's credit standards and other credit decision criteria. Frankly, I consider myself to be above average when it comes to knowledge about the credit decision. Eight years ago, I was a new member of the Harvard economics faculty and my wife and I were first time homebuyers. Even with helpful suggestions from colleagues who had recently gone through the same experience, finding a home mortgage was a daunting and difficult experience.

Thus, a good part of the problem that we face in reducing disparities has to do with myth and ignorance. There is a widespread lack of recognition of the size and potential value of minority lending. This may adversely affect both strategic planning by institutions and the judgment of individuals making loan decisions. We have created a needlessly complex conundrum of regulations which attempt to substitute rules for reason. Standardization, while well intentioned, limits the ability of individuals within the system to meet the needs of individuals who are different from the standard. Finally, the widespread ignorance of credit rules in the population may not be met by sufficient willingness of lending institutions to provide information to their customers.

I think that these problems are all personified in the case of Willard Brown of St Louis. Mr. Brown, who is an African American, was rejected four times before finally getting a mortgage loan. He had steady employment — over 20 years at the same job, a salary in excess of $30,000, and an outstanding credit report. The reason for his rejection was high credit card debt, which put his ratios in excess of Fannie Mae guidelines. But, Mr. Brown had cash in the bank, in fact more than enough to bring his ratios into line. None of the first four loan officers suggested that he do so, although it would have meant a good loan to a qualified customer.

Mr. Brown's case is one in which the lending institutions obviously ignored the potential of the black community, were hamstrung by needlessly complicated guidelines, and failed to make their process clear to their customers. In practice, this case reflects both the "thicker file" and the coaching phenomenon I spoke of at the beginning of this talk. This case is not only exemplary of the ignorance I spoke of, it indicates a strong predilection on the part of the lender to resist any effort to disclose the facts. Such behavior reflects not only a potential problem in racial attitude, it reflects a fundamental problem of business attitude. The key to solving our lending problems, I believe, lies in good old fashioned business sense about how to run a service business: how you treat the customer is key.

Back in May, here in Los Angeles, I recommended to the members of the California Bankers Association that they experiment with using shoppers at their institutions to test the fairness of their lending practices. Such shoppers should explicitly work for the bank as what they are gathering is proprietary information regarding customer service. In combating discrimination, it is important to make sure that loan officers are extending the same courtesy and even the same level of coaching to all customers of all races. But, an equally low level of assistance to both black and white customers is not the answer. We need more customer education for everyone. Banks must make clear what is expected of the customer, or the customer is bound to end up with a bad feeling. In fact, heightened sensitivity to the opportunities offered by minority lending are appropriate all the way up the decision hierarchy.

Community outreach is also an important way of providing quality service while finding new customers. Huntington National Bank in Columbus, Ohio, has begun a lending program which works through churches in black neighborhoods. The program includes classes on how to apply for loans along with basic credit information. Let me note that the program could prove a good way for Huntington to evaluate credit risk by providing a potentially valuable credit reference. Here is a way of gathering more information in making an informed loan judgment, the exact reverse of the simple statistical approach, which actually requires discarding valuable information.

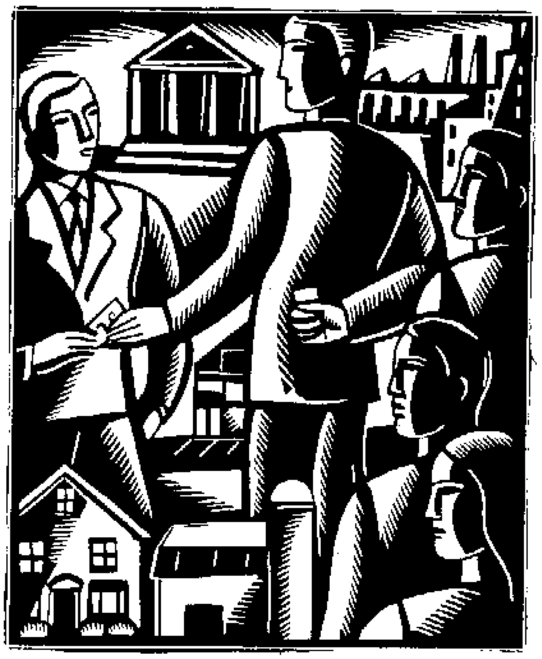
Another outreach technique used by some lending institutions is simply providing a second, internal review of mortgage applications that are turned down. Usually this is done by separate officers or committees that can take a fresh look at each application and ensure that policies are applied in the same manner for all applicants.

A multi-bank approach which has proven successful in expanding minority lending is the use of mortgage review boards. In Boston and Detroit, rejected mortgage applicants may forward their applications to the board to appeal the outcome of a lending decision. Members of the review board are banking and thrift institutions which are active in local mortgage lending. Rejected applicants who meet the Board's criteria are provided loans by Board members on a rotating basis. Philadelphia has a similar, but more aggressive, program targeted at specific neighborhoods which involves automatic referral of applications that, based on a preliminary review, suggest rejection. It also entails a community outreach component, use of flexible underwriting standards, and credit counseling. Because it adds a second judgment, this program helps ensure the fairness of the loan process. It also promotes consumer education and understanding of the mortgage market.

A final hurdle to success is the need to seek greater flexibility in lending criteria and to reinsert judgment into the loan process. In spite of the advantages of the secondary market in the form of liquidity, there are costs in terms of the variety of people served. Ultimately, the solution is for banks to take on more of their mortgage loans for their own portfolios, and not sell them in the secondary market. Of course, this means that the bank, not the market, must absorb any credit risk from such loans. But Ultimately, our capital markets will catch on to this. Banks which keep mortgages for their own portfolios have an incentive to know something more about their customers than banks which resell packaged portfolios of mortgages in the secondary market. Once that information gets out, it should be clear which is the smarter bank in which to inveSt I might add that one large national bank has already decided to keep a larger share of its minority mortgage and small business loans in its own portfolio.

I would like to close with one final observation. By any standard, America is the most successful multi-racial society that history has ever known. That doesn't mean that things are fine — they're not. But we've got everyone else who has ever tried beat by a long shot. I think the reason for this is our willingness and constant efforts to try to make things better. I am very happy to be part of this meeting today, which I believe is yet another example of Americans, coming together, in just such an effort.

Section II
Community Reinvestment Act



Community Reinvestment Act

The Federal Reserve and other supervisory agencies, such as the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency, regulate banks to ensure financial safety and quality consumer services. The 1977 Community Reinvestment Act (CRA) focuses on consumer concerns by requiring regulatory agencies to evaluate banks' responsiveness to community credit needs and to determine if there is evidence of discriminatory practices. The act was passed by Congress to end the practice of redlining, where a bank makes a rule not to award loans in certain neighborhoods.

Each bank and savings and loan is required to adopt a public "CRA statement" that specifies the community it serves, lists the principal types of credit it offers and indicates where a person should write to comment on the institution's CRA performance. Each bank must also maintain a file of public comments describing its CRA performance and publicly display a notice about the availability of its CRA statement and public comment file.

Regulatory agencies assess CRA performance by conducting examinations of banks and thrifts. Agencies use 12 performance factors to compute an overall rating for a bank. The penalty for non-compliance affects a bank when applying for an expansion or merger through a supervisory agency. If a bank has a low CRA rating, the agency may decide not to approve its application.

As an uncommonly vague piece of legislation, CRA does not make banks follow rigid guidelines. Banks are free to design their own reinvestment plans specific to their particular communities' needs. However, without rigid guidelines and strong incentives, banks may not be compelled to make reinvestment loans. How much regulation is enough and how much is too reinvestment loans. How much regulation is enough and how much is too much? This remains an important question for banks and their communities.

CRA is one of four laws intended to encourage fair lending. The 1968 Fair Housing Act and the 1974 Equal Credit Opportunity Act make discrimination in selling real estate and providing credit illegal. The 1975 Home Mortgage Disclosure Act (HMDA) requires banks to provide public information concerning housing-related loan applications. CRA and HMDA data assist consumers in monitoring banks' performance.

Section II Readings:

Grandstrand, Karen. "Fair Lending: The Issue of the '90s May Inspire More Regs," *fedgazette*, Vol. 5, No. 3 (July 1993), 18-19.

"A Citizen's Guide to the CRA," Federal Financial Institutions Examination Council (FFIEC), June 1992. [This excerpt explains the background, requirements and application process of CRA. The whole publication can be found in many major libraries.]

"Lending Discrimination Laws," adapted from "CRA Guidelines: Discrimination and Other Illegal Credit Practices," Federal Reserve Bank of Chicago, April 1991.

Other Resources on CRA

Local Banks

All banks are required to have a CRA statement and a CRA file open for public inspection. The most recent CRA exam report and CRA rating are included in the public file. Talk with the bank's CRA compliance officer to receive further information. (See Interviews in Section I.)

Kimberely

Kimberely, the Federal Reserve Bank of Minneapolis' electronic database, can be contacted 24 hours a day, every day, at (612) 340-2489. There is no fee for Kimberely's services — you pay only your telephone charges.

Files on Kimberely that are related to the essay contest are listed in the Bibliography in Section VII.

The Ninth District Banking Directory, published in July, includes financial information for all Ninth District banks. It can be found in Kimberely, in a Lotus spreadsheet format, under directory 7, file name, BKDMN92.WK1. A separate file exists for each state in the District.

Banking Regulators

Federal Deposit Insurance Corp.
James O. Leese
Regional Director
2345 Grand Avenue
Suite 1500
Kansas City, MO 64108
(816) 234-8000
(for MN, ND and SD)

George J. Masa
Regional Director
25 Ecker Street
Suite 2300
San Francisco, CA 94105
(415) 546-0160
(for MT)
Simona L. Frank
Regional Director
30 South Wacker Drive
Suite 3100
Chicago, IL 60606
(312) 207-0210

(for MI and WI)

Federal Reserve Bank
Federal Reserve Bank of
Minneapolis
Public Affairs
PO Box 291
Minneapolis, MN 55480-0291
(612) 340-2447

**Office of the Comptroller
of the Currency**
Midwestern District
2345 Grand Avenue
Suite 700
Kansas City, MO 64108
(816) 556-1800

Central District
One Financial Place
440 South LaSalle Street
Suite 2700
Chicago, IL 60605
(312) 663-8000
(for WI and MI)

Western District
50 Fremont Street
Suite 3900
San Francisco, CA 94105
(415) 545-5900
(for MT)

Office of Thrift Supervision
Midwest Regional Office
122 W. John Carpenter Freeway
Suite 600
Irving, TX 75039
(214) 281-2000
(for ND, SD, MN)
Central Regional Office
111 E. Wacker Drive
Suite 800
Chicago, IL 60601
(312) 565-5300
(for WI and MI)

West Regional Office
Pacific Telesis Center

One Montgomery Street
Suite 400
San Francisco, CA 94120
(415) 616-1500
(for MT)

State Bank Supervisory Officials

Michigan
Russell S. Kropschot
Acting Commissioner
Financial Institutions Bureau
206 E. Michigan Avenue
Grandview Plaza
Floor 5
Lansing, MI 48909
(517) 373-3460

Minnesota
James G. Miller
Deputy Commissioner
133 E. 7th Street
St Paul, MN 55101
(612) 296-2715

Montana
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Commissioner of Financial
Institutions
1520 E. 6th Avenue
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North Dakota
Gary D. Preszler
Commissioner of Banking and
Financial Institutions
600 E. Boulevard Avenue
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(701) 224-2253

South Dakota
Richard A. Duncan
Director of Banking
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500 E. Capitol
Pierre, SD 57501-5070

(605) 773-3421

Wisconsin
Richard Dean
Commissioner of Banking
131 W. Wilson Street
8th Floor
PO Box 7876
Madison, WI 53707-7876
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fedgazette newspaper (also on the Kimberely database, file:grand.edi)
Volume 5, No. 3
July 1993
Federal Reserve Bank of Minneapolis

Fair lending: The issue of the '90s may inspire more regs

By Karen Grandstrand
Assistant Vice President, Banking Supervision, Federal Reserve Bank of Minneapolis

"The regulatory issues in the 1990s will not be limited to safety and soundness, but will increasingly emphasize fairness: whether or not banks are fulfilling the needs of their communities."

Lawrence B. Lindsey
Member, Board of Governors of the Federal Reserve System, Address to the California Bankers Association, May 11, 1992

In 1989, 1990 and 1991, Congress passed major banking legislation to address the savings and loan debacle of the 1980s — the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA), the Comprehensive Thrift and Bank Fraud Prosecution and Taxpayer Recovery Act of 1990, and the Federal Deposit Insurance Corp. Improvement Act (FDICIA). Momentum is growing for more legislation. But this time the focus is not on bank failures or losses to the insurance fund. The banking issue of the 1990s is lending discrimination.

Currently there are four primary federal fair lending laws, all were passed in the late 1960s and 1970s. The first focuses on federal financial supervisory agencies, and the other three are directed at lenders.

- The Community Reinvestment Act (CRA) was enacted in 1977 and directs supervisory agencies to encourage financial institutions to help meet the credit needs of their delineated communities, including low- and moderate-income neighborhoods, consistent with safe and sound banking practices. The agencies are also directed, as part of their examination process, to assess an institution's record of serving its entire community. The primary method of enforcement is through the applications process — the agencies are to take an institution's record of compliance with the CRA into account when assessing an institution's application for approval regarding a deposit facility (a charter, a merger, an acquisition, a branch, an office relocation or deposit insurance).

- The Home Mortgage Disclosure Act of 1975 (HMDA) requires financial institutions to provide information to the public concerning housing-related loan applications. The HMDA does not provide for governmental rewards or sanctions for any particular lending practices.

- The Equal Credit Opportunity Act (ECOA) was enacted in 1974 to promote the availability of credit without regard to race, color, religion, national origin, sex, marital status, age, receipt of public assistance funds or the exercise of any right under the Consumer Credit Protection Act.

- The 1968 Fair Housing Act makes it unlawful for any person who engages in real estate lending to discriminate. The ECOA and the Fair Housing Act are enforced through private litigation and agency action.

Recent studies, anecdotal information and press reports contend that this regulatory scheme is flawed. The banking industry contends that it is overly burdensome, while community groups are pressing for more regulation and contend that current legislation lacks teeth, and has failed to produce results.

The current climate

The House and Senate are considering approximately 10 bills to amend the CRA and several other bills that would expand HMDA-type disclosure rules. One of the top banking priorities for the Clinton administration is fair lending.

Agency activity is also escalating:

- September 1992 — the U.S. Department of Justice issues a consent decree against Decatur Federal Savings and Loan Association, Atlanta, Ga., charging the thrift with discriminating against black homebuyers.

- October 1992 — the Federal Reserve Bank of Boston publishes "Mortgage Lending in Boston — Interpreting HMDA Data." The study concludes that a black or Hispanic applicant in the Boston area is roughly 60 percent more likely to be denied a mortgage loan than a similarly situated white applicant.

- 1991 to 1993 — the Federal Reserve System develops HMDA analysis reports and specialized HMDA analysis training for bank examiners.

- February 1993 — the Federal Reserve System rejects a proposal by Farmers & Merchants Bank of Long Beach, Calif., to establish a branch office, based on the bank's CRA performance and compliance with consumer lending laws.

- April 1993 — the Federal Reserve Bank of Boston publishes "{Closing the Gap:<A Guide to Equal Opportunity Lending."

- May 1993 — the Office of the Comptroller of the Currency (OCC) announces that it intends to use examiners posing as loan applicants to test for discrimination.

- May 1993 — the Department of Housing and Urban Development(HUD) and the OCC announce the formation of a joint working group to strengthen the government's efforts to enforce anti-discrimination laws.

- May 1993 — the Federal Reserve System denies an application by First Colonial Bankshares Corp. of Chicago, Ill., based on the less-than-satisfactory CRA record of one of its bank subsidiaries.

- May 1993 — the four financial institution regulatory agencies send a letter to all banks and thrifts, reiterating their commitment to effective enforcement of fair lending laws. The letter urges institutions to enhance employee training, internal second review programs for loan applications that might otherwise be denied, participation on multi-lender mortgage review boards, and affirmative marketing and call programs.

- June 1993 — the four financial institution regulatory agencies announce fair lending initiatives to enhance their ability to detect lending discrimination.

Several states have also become active in the lending discrimination area. California is close to passing a minority-lending bill that many view as a model for federal legislation. The law would require all financial institutions that have at least $100 million in assets and do business with state or local agencies to make extensive disclosures about minority lending and hiring. The State of New York, which has a community reinvestment law that is virtually identical to the federal act, has proposed an alternative approach to CRA participation and enforcement. Under the proposal, depository institutions could earn CRA "credit" based on identified specific activities. The system would require institutions to establish investment targets for CRA, measure the investments in relation to each institution's assets, and tie CRA ratings to minimum specified amounts of such investments.

New legislation

Given the current climate, new legislation seems inevitable. But, before enacting more laws, policymakers need to assess the strengths and weaknesses of the current system to ensure any new legislation creates more benefits than burdens.

Contrary to popular belief, the current system has some strengths. First, the additional HMDA reporting requirements of 1989 and legislation requiring public disclosure of CRA ratings have given fair lending greater visibility and increased attention. The 1990 and 1991 HMDA data and studies of that data have moved the lending discrimination debate from whether discrimination exists to how to address existing discrimination. This, in turn, has led regulators to devote additional resources to the area, increased the number of public protests of financial institution applications and led to increased lending activity. The market discipline components of the current system are producing results.

A second strength of the current system is flexibility. Under the CRA and its implementing regulations, bank examiners take into consideration an institution's financial condition and size, and local circumstances. While this flexibility has been criticized for making CRA too subjective and uncertain, such flexibility is essential. No two banks and no two communities are the same.

A weakness in the current system is that it has not kept pace with structural changes in the industry. For example, a bank holding company with 20 subsidiary banks has 20 separate CRA ratings, while a bank holding company with one bank and 19 branches has only one rating. If interstate branching is enacted, the current system of assigning one rating per institution will become even more troublesome.

Another area that should be reviewed is the four-tiered rating system. The current satisfactory category is quite broad. Thus, consideration should be given to creating a five-tiered system, especially if any type of safe harbor legislation is passed.

I have pointed out just a few arguable strengths and weaknesses of the current system. These and many others need to be considered when proposing changes to our regulatory scheme. More importantly, none of us should wait for new regulation to fix the problem. Lenders and regulators should work together now and look for ways to eliminate unjustified lending disparities. New legislation may not be, and need not be, the best or only solution to the banking issue of the '90s.

About This Guide

A Citizen's Guide to the CRA is designed to help people understand the Community Reinvestment Act (CRA) and the responsibility it gives to the federal financial supervisory agencies to encourage financial institutions to reinvest in the local communities where they do business.[1] This guide describes the origins of the CRA, the policies and procedures the agencies use to enforce it, and the important changes to the CRA that took effect in July 1990. It explains how members of the public can be involved in the "CRA process" by communicating with their local financial institutions and with the agencies that regulate them, and how public input is considered when certain types of applications are filed.

Banks and savings associations are supervised by one of the four agencies below. These agencies enforce the CRA as well as consumer protection laws and many other laws governing the financial services industry.

- Federal Deposit Insurance Corporation (FDIC)—supervises state-chartered banks that are not members of the Federal Reserve System.

- Federal Reserve System (FRS)—supervises state-chartered banks that are members of the Federal Reserve System.

- Office of the Comptroller of the Currency (OCC)—supervises national banks. Often the word "National" appears in the bank's name, or the initials "N.A." or "N.T. & S.A." follow its name.

- Office of Thrift Supervision (OTS)—supervises federally and state-chartered savings associations as well as federally chartered savings banks. The names of these institutions generally identify them as savings and loan associations, savings associations, or savings banks. Federally chartered savings institutions have the word "Federal" or the initials "FSB" or "FA" in their names.

If you are uncertain about which agency supervises a financial institution, you can call the FDIC toll-free at 800-424-5488.

This guide is published by the Federal Financial Institutions Examination Council (FFIEC), which is an umbrella group for the agencies.[2]

[1] The federal financial supervisory agencies will be referred to simply as "the agencies" in this guide.

[2] The National Credit Union Administration, which supervises federally insured credit unions, is a member of the FFIEC, but it does not participate in the CRA supervisory process. See the paragraph, *Who is covered?*

Background

The history of the Community Reinvestment Act (CRA) really began long before it was enacted in 1977. Traditionally, financial institutions in the United States have had an obligation to serve the public because of the privileges they receive from the government—which other business do not. For example, financial institutions have charters to do business, obtain federal deposit insurance, and borrow money under special arrangements from the Federal Reserve discount window and the Federal Home Loan Banks. These privileges gave rise to the principle, found in our banking laws as far back as the 1930s, that financial institutions should serve the "convenience and needs of their communities."

In the years leading to passage of the CRA, there was considerable concern about ensuring fair access to credit, especially in the inner cities. Community groups spoke out against redlining—the perceived practice of drawing red lines around disfavored neighborhoods where money would not be lent, regardless of the creditworthiness of individual loan applicants. Many people felt that the visible economic decline of urban areas was aggravated by financial institutions, which were seen as taking deposits out of the neighborhoods from which they came and investing them elsewhere. Against this backdrop, the attention of the Congress was turned to the problem of revitalizing neighborhoods and the role financial institutions could play in that effort.

The CRA: What it does and does not do

The CRA affirms that financial institutions have an obligation to help meet the credit needs of their entire communities, including low- and moderate-income neighborhoods. It requires that the agencies (1) use their authority to encourage them to do so; (2) regularly assess the CRA performance of the institutions they supervise; and (3) take CRA performance into account when deciding whether to allow institutions to expand their businesses in certain ways.

The law recognizes that financial institutions should address their CRA responsibilities in keeping with safe and sound banking practices. The CRA does not require financial institutions to make loans that could jeopardize their safety nor dictate the type, amount, or terms of the loans they make. The Congress believed that precise requirements, representing credit allocation, should be avoided.

Who is covered?

The CRA applies to federally insured commercial banks, savings banks, and savings associations that are in the business of providing credit to the public—whether their operations are retail or wholesale. Exempted are those institutions which serve solely as correspondent banks, or as trust companies or as check clearing agents and do not extend credit to the public for their own account. Credit unions are not subject to the CRA.

The CRA policy framework

In March 1989, the agencies issued a Joint Policy Statement on CRA. Based on more than ten years' experience with enforcement of CRA, the statement addresses key questions that bankers and the public have raised.

The Joint Statement outlines what the agencies expect from financial institutions in fulfilling their CRA responsibilities. The agencies firmly believe that CRA efforts should be part of an ongoing *process* that involves specific steps to determine the credit needs of the community (including those of low-and moderate-income neighborhoods) and to help address those needs through prudent lending. The management of a financial institution should be involved in the CRA process and oversee it, just as with other business plans and operations. A major element in making the process work is establishing a dialogue with all segments of the community—local governments, businesses, neighborhood organizations, and civic, consumer, minority, and religious groups, as well as those concerned with housing and other community matters.

The Joint Statement also makes clear that the dialogue with the community should be two-way, involving an ongoing effort by members of the public to make their concerns known. Just as financial institutions are expected to communicate with people in the communities they serve, community groups are urged to raise CRA-related issues with an institution's management and with the appropriate supervisory agency as soon as possible.

Financial institutions have considerable latitude in which to develop their own CRA programs and to offer the loans and services best suited to their expertise, their business objectives, and their community's needs. By way of guidance, the Joint Statement provides examples of the kinds of initiatives the agencies have found in effective CRA programs.

Important changes to the CRA

Amendments to the CRA, included in the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) and effective as of July 1, 1990, laid the groundwork for a greater degree of public involvement in the CRA process.

As a result of the amendments, the agencies prepare a written assessment, including the assigned rating of the CRA performance of each institution they examine. These assessments, called CRA Performance Evaluations, are available to the public. They describe the activities the institution has undertaken under each of twelve assessment factors (presented on page 6) and the conclusions examiners have drawn from them.

In assigning a CRA rating, examiners take into account several considerations, including an institution's size, expertise, financial strength, the type of community it serves (for example whether it is urban or rural), local economic conditions, and the nature of the institution's competition and business strategy. With these considerations in mind, examiners make judgments about the institution's CRA performance under the twelve assessment factors.

The purpose of the CRA Performance Evaluation is to help the reader understand the overall level of the institution's CRA performance.

It is important to remember that the ratings and the CRA Performance Evaluations do not in any way represent the financial condition of the institution.

The CRA rating system identifies four levels of performance that may describe an institution's record of meeting community credit needs:

- Outstanding
- Satisfactory
- Needs to improve
- Substantial noncompliance

The guidelines that examiners use in rating an institution incorporate much of the guidance that the Joint Statement provides to institutions.

While not changing the basic thrust of the CRA, the amendments in FIRREA gave the agencies an important new task—making public their assessments of an institution's performance, to open the CRA process to more informed public discussion and involvement.

Other changes to federal law in FIRREA also aimed to put more information about financial institutions' lending efforts, notably in the housing area, in the public domain. Amendments to the Home Mortgage Disclosure Act (HMDA) expanded the scope of information that covered lenders must report every year about their housing-related loan activity. Such information now includes the race, sex, and income of all applicants, not only of those who were granted credit. The new HMDA requirements give interested members of the public more information about the way financial institutions are serving the needs of their neighborhoods for housing credit and should suggest the areas in which greater efforts may be needed.

The CRA assessment factors

1. Activities conducted by the institution to ascertain the credit needs of its community, including the extent of efforts to communicate with members of its community regarding the credit services being provided by the institution.
2. The extent of the institution's marketing and special credit-related programs to make members of the community aware of the credit services offered by the institution.
3. The extent of participation by the institution's board of directors in formulating the institution's policies and reviewing its performance with respect to the purposes of the Community Reinvestment Act.
4. Any practices intended to discourage applications for types of credit set forth in the institution's CRA Statement.
5. The geographic distribution of the institution's credit extensions, credit applications, and credit denials.
6. Evidence of prohibited discriminatory or other illegal credit practices.
7. The institution's record of opening and closing offices and providing services at offices.
8. The institution's participation, including investments, in local community development and redevelopment projects or programs.
9. The institution's origination of residential mortgage loans, housing rehabilitation loans, home improvement loans, and small business or small farm loans within its community, or the purchase of such loans originated in its community.
10. The institution's participation in governmentally insured, guaranteed, or subsidized loan programs for housing, small businesses, or small farms.
11. The institution's ability to meet various community credit needs based on its financial condition and size, and legal impediments, local economic conditions, and other factors.
12. Other factors that, in the agency's judgment, reasonably bear upon the extent to which an institution is helping to meet the credit needs of its entire community.

CRA Requirements

What the agencies must do

CRA examinations are the main vehicle for the agencies to evaluate financial institutions' CRA activities and, at the same time, to encourage them to do better. Examiners from all the agencies follow uniform CRA examination procedures, which focus attention in a methodical way on each of the twelve assessment factors. Based on examination findings, ratings are assigned in accordance with the interagency CRA rating system. To help ensure a balanced perspective, examiners may also conduct interviews with representative individuals and groups from the local community, outside the institution, to hear their views on the community's credit needs and the performance of local financial institutions.

Examiners' findings are orally communicated to institution management at the end of the examination, and a written examination report and CRA Performance Evaluation are sent later. After the examination, institutions receive continued supervisory attention through correspondence, follow-up visits, and subsequent examinations.

Besides conducting examinations, the agencies may undertake outreach efforts to educate financial institutions about the range of opportunities and techniques for community development lending. Government agencies, private and nonprofit developers, national financial intermediaries, and others often participate in this effort. The emphasis is on helping build public-private partnerships that can effectively address community reinvestment needs.

The agencies must take CRA performance (and other factors) into account when evaluating applications by the institutions they regulate to engage in certain activities. The applications process and the way citizens can participate in it are discussed later in this guide.

What financial institutions must do

Institutions must adhere to substantially identical regulations adopted by the agencies to implement the CRA (Appendix C provides citations for these regulations and pertinent application provisions). The regulations specify the twelve factors that examiners use in assessing institutions' performance under the CRA. They also set out three specific technical requirements, which follow.

1. A Community Reinvestment Act Statement for each local community the institution serves. Each CRA Statement must be updated and approved annually by the institution's Board of Directors. It must contain the following:

- a map showing the local community that the institution serves
- a list of the types of loans the institution is willing to make within its community
- a notice of the process by which the public can comment on the institution's CRA performance (The contents of the notice are discussed in detail below.)

In addition, the agencies—through the CRA regulations and the Joint Statement on the CRA—strongly encourage institutions to include in their CRA Statements a description of their CRA efforts. Such an "expanded" CRA Statement would, for example, tell the public how the institution has identified community credit needs and has communicated with people in the community about them, steps it has taken to market and advertise its services, and any special credit-related programs it offers.

The CRA Statement must be readily available for the public to review, on request, at an institution's principal office and at each branch office in the local community delineated in the statement. An institution may charge for copies, but it may not charge more than the cost of reproduction and mailing, if applicable.

2. A file that contains written comments from members of the public about the institution's CRA performance. The "CRA Public File" should also contain the following:

- any responses the institution has made to the public's comments
- the institution's CRA Statements for the past two years
- the most recent CRA Performance Evaluation prepared by its regulatory agency, which must be placed in the file within thirty business days after the institution receives it. If the institution chooses, it may also include any response it has made to the Performance Evaluation.

The CRA Public File must be available for the public to inspect at the institution's principal office and at least one office in each local community (if the institution serves more than one community). No fee may be charged for public inspection of the contents of the file but, as with the CRA Statement, a fee (not to exceed the cost of reproduction and mailing, if applicable) may be charged for copies of the Performance Evaluation.

The agencies also maintain files of comments received from the public on the performance of the institutions they regulate. To review these files, members of the public should contact the agencies' district or regional offices (see appendix A for the addresses).

3. A notice, posted in the lobby of each of the institution's offices, which lets the public know the following:

- where it can get copies of the institution's CRA Statement
- where, and to whom, it may send comments about the institution's CRA performance
- where to locate the institution's public file(s)
- the address of the appropriate supervisory agency to which the public may send comments about the institution's CRA performance
- the fact that the CRA Performance Evaluation is available for public inspection (once the first one has been received), and where it is located
- whether the institution is owned by a holding company.

- how to obtain announcements from the supervisory agency of any applications, for which CRA is considered, filed by the institution.

You may call, write, or visit your local financial institution to get a copy of its most recent CRA Performance Evaluation. You should not be charged more than the cost of duplicating and mailing it (if applicable). Check the CRA notice posted in the institution's lobby for the location of the institution's offices where the CRA Public File, including the CRA Performance Evaluation, is available.

CRA and the Applications Process

The CRA requires that CRA performance be considered with other factors when the agencies evaluate certain types of applications by financial institutions and their parent companies, known as holding companies. This requirement provides a powerful incentive for financial institutions to meet their CRA obligations should they intend to expand their business. Adverse findings about an applicant's CRA performance can result in denial of an application.

What kinds of applications are covered?

The types of applications covered are those asking the agencies for permission to do the following:

- obtain federal deposit insurance (includes start-up or "de novo" institutions and conversions from a state to national charter and vice versa)
- establish a branch or other facility authorized to receive deposits, or relocate a main office or existing branch (including federally insured branches of foreign banks)
- merge, consolidate, or acquire another financial institution, or acquire deposits from another financial institution
- form a bank or savings association holding company.

Applications for these activities are filed with and handled by the applicant's supervisory agency. All applications for savings association holding companies are evaluated by the Office of Thrift Supervision. All applications filed by bank holding companies are evaluated by the Federal Reserve, even though their subsidiary banks may be supervised by one or more of the other agencies.

How the agencies review CRA performance

In considering applications covered by the CRA, the agencies routinely review the applicant’s performance in helping meet the credit needs of its entire local community.[3] Great weight is given to the findings of CRA examinations. although sometimes the agencies may need to obtain additional information to update the examination record or to clarify any questions about how well institutions are actually performing.

The agencies must evaluate more than CRA in the applications process. They must assess also the financial capacity of the applicant institution and the competency of

[3] Where the applicant is a bank or savings association holding company, theCRA performance of all subsidiary financial institutions is reviewed. Holding companies, per se,do not have CRA responsibilities, but the financial institutions they own or control do. Thus, the agencies expect that holding companies will oversee the CRA performance of their subsidiariesand be accountable for it.

its management, the effect of the proposal on competition, and any legal constraints or considerations the proposal may entail.

The agencies believe that institutions should address their CRA responsibilities and have the necessary policies in place and working well before they file an application. In fulfilling their responsibilities under the CRA, institutions may initiate programs for future action to ensure a strong CRA record or to resolve CRA issues. Commitments for future action are not viewed as part of the CRA record of performance of the institution, but they may be given weight as an indicator of potential improvement in the institution's performance. The agencies can use commitments for such improvement to address specific problems in an otherwise satisfactory record or to address CRA performance when a troubled institution is being acquired. In some cases, these commitments have an important bearing on the determination that CRA considerations are consistent with an approval of the application. In general, institutions cannot use commitments made in the applications process to overcome a seriously deficient record of CRA performance. Commitment for improvements in an institution's performance can be used to address specific problems in an otherwise satisfactory record. The agencies monitor the fulfillment of commitments made to the agencies in the applications process and may use their supervisory authority to enforce them. Where appropriate, the agencies may, by granting conditional approval of an application, also require financial institutions to take specific actions to improve CRA performance; the approval becomes final only after the conditions have been satisfied.

Opportunity for public input

An important feature of the applications process is the opportunity for the public to comment, in writing, on any or all of the factors the agencies must consider in acting on an application—including CRA performance. Public comments may help provide a more complete or more current picture of CRA performance than is indicated by examination records alone. Written comments, which may express either support for or opposition to the application, become part of the record, which the agencies carefully examine in making their decision. Comments regarding an application that are critical of an applicant's CRA performance are commonly referred to as "CRA protests."

The comments need not be submitted in a legal brief or any other particular format. However, they should be supported with facts about the applicant's performance and should be as specific as possible in explaining the basis for the proteSt For example, they could discuss any information that the commenter believes shows an institution's poor lending performance or illegal discrimination in its lending or a failure to comply with the technical requirements of the CRA (such as an improper delineation of its local community or an inaccurate listing of loan products in its CRA Statement). Stating whether the issues raised in the protest have previously been brought to the attention of the institution's management is also helpful to the agencies.

When to submit comments

Anyone wishing to comment on an application should do so in a timely fashion, to give the agencies time to analyze the issues raised and any responses to them from the applicant. The length of the period for comment varies somewhat from agency to agency and by type of application. The following chart provides basic information about the length of this period; the agencies' district or regional offices can provide further guidance.

Length of public comment period for applications subject to CRA

FRB	30 days for most applications	
FDIC	15 days for most applications; 21 days for office relocations; mergers[4]	30 days for
OCC	30 days for most applications; 10 days for Customer-Bank Terminal branches	Communication
OTS	10 days for most applications; a 7-day extension is granted on request	written

[4] Periods are counted from the date of the publication of the last notice or receipt by the FDIC Regional Office, whichever is later.

The Role Citizens Can Play

The CRA provides a framework for productive interaction between financial institutions and all those who make up a community—representatives of local government, businesses, civic and consumer organizations, trade associations, the religious community, and many others. It can help bring together their resources and expertise to address concerns and needs regarding community development. The CRA works best when it is the basis of an ongoing dialogue and is not associated exclusively with pending applications by financial institutions.

The CRA process is strengthened by the public availability of CRA Performance Evaluations prepared by the agencies. The public is encouraged to contact the institution directly to obtain a copy of the CRA Performance Evaluation. To facilitate public access to CRA Performance Evaluations, the agencies regularly publish listings of the institutions that have CRA Performance Evaluations, and their corresponding CRA ratings, available for public review.

You can be kept informed of which institutions have publicly available CRA Performance Evaluations, and their CRA ratings, through a listing published at least quarterly by each agency for the institutions it supervises. Contact the agency's district or regional office to be placed on the mailing liSt[5]

The CRA Performance Evaluations are an important source of information about the CRA activities of local financial institutions. They explain how the agencies have judged the institutions' efforts to help meet community credit needs. However, the Performance Evaluations represent the agencies' judgments, based on information available at the time of examination. The agencies hope that members of the public will present their own observations about an institution's CRA performance, especially in light of changes in community credit needs and the opportunities these changes present for involvement by financial institutions. The public is encouraged to write letters to the institution for inclusion in the CRA Public File or directly to the agency, at any time.

[5] For institutions supervised by the FDIC, please write the FDIC's Office of Corporate Communication at 550 17th St., NW, Washington, DC 20429.

Lending Discrimination Laws

Adapted from "
CRA Guidelines: Discrimination and
Other Illegal Credit Practices"

Federal Reserve Bank of Chicago

During a CRA examination, financial institutions are evaluated on how they comply with the anti-discrimination and illegal credit practices legislation. Banks are expected to implement employee training programs and compliance procedures to ensure that loan applications aren't discouraged on any prohibited basis.

A CRA examiner evaluates the following: the methods and effectiveness of an institution's efforts to solicit credit applications from all segments of its community, including low- and moderate-income neighborhoods; the effectiveness of an institution's assessment of the adequacy of its non-discriminatory policies, procedures and training programs; and an institution's level of compliance with anti-discrimination laws and regulations, including the 1974 Equal Credit Opportunity Act, the 1968 Fair Housing Act, the 1975 Home Mortgage Disclosure Act, and any agency regulations regarding non-discriminatory treatment of credit applicants.

An examiner also determines whether the institution has developed policies, procedures and training programs to ensure that credit applicants are not illegally discouraged or prescreened.

Banks should establish formal training procedures for all employees involved with credit applications. Banks should also establish formal monitoring procedures to ensure non-discriminatory evaluations of credit applications.

An institution with a satisfactory program solicits credit applications from all segments of its local community, including low- and moderate-income neighborhoods. The board of directors and senior management develop adequate policies, procedures and training programs to support non-discriminatory lending and credit activities. The institution periodically assesses the adequacy of programs through internal reviews and management reporting mechanisms.

Summary of Regulation B: The Equal Credit Opportunity Act

The Equal Credit Opportunity Act prohibits discrimination involving credit transactions on the basis of race, color, religion, national origin, sex, marital status, age (provided the applicant has the capacity to contract), receipt of income from public assistance programs and good faith exercise of any rights under the Consumer Credit Protection Act. The regulation applies to all persons who regularly participate in decisions regarding whether or not to extend credit or the amount that is to be extended.

The regulation has been structured to cover the requirements imposed by a bank before, during and after the application and evaluation process of granting credit.

Unlawful discrimination also occurs if an applicant is denied credit because of prohibited considerations concerning the applicant's business associates or persons who will be related to the credit transaction (for example, the race of persons residing in the neighborhood where collateral is located).

To prevent discrimination, Regulation B imposes a delicate balance on the credit system, recognizing both the bank's need to know as much as possible about a prospective borrower and the borrower's right not to disclose information that is irrelevant to the transaction. The regulation deals with receiving, evaluating, and acting on the application, and furnishing and maintaining credit information. One should note that Regulation B does not prevent a creditor from determining whether pertinent information is needed to evaluate an applicant's creditworthiness.

Summary of the Fair Housing Act

"It is the policy of the United States to provide, within constitutional limitations, for fair housing throughout the United States."

—Section 801 of the Fair Housing Act

Under the Fair Housing Act, banks may not deny a loan or other financial assistance for the purpose of purchasing, constructing, improving, repairing or maintaining a dwelling because of the race, color, religion, national origin or sex of the loan applicant, any person associated with the loan applicant, any present or prospective owner of the dwelling, any lessees, or any tenants or occupants.

The Act also prohibits fixing the amount, interest rates, length of time or other terms of the credit on the basis of race, color, religion, national origin or gender.

With regard to the sale or rental of housing, the following activities are illegal if they are done on any of the prohibited bases:

1. Refusing to sell or rent housing after a bona fide offer is made, or refusing to negotiate to sell or rent a dwelling;
2. Discriminating with respect to terms of sale or with respect to the provision of services in connection with the sale or rental;
3. Making any oral or written statement or advertisement with respect to a sale or rental which indicates a preference that is based on a prohibited consideration or that indicates an intent to discriminate;
4. Inducing or attempting to induce for profit the sale or rental of property through representations regarding the entry or prospective entry into the neighborhood of a certain person or persons.

The Fair Housing Act also prohibits refusing to sell or rent, refusing to negotiate for the sale or rental of a dwelling, or to "otherwise make unavailable or deny" a dwelling on a prohibited basis.

People can file complaints with the U.S. Department of Housing and Urban Development which investigates these complaints and attempts to resolve them.

Summary of the Home Mortgage Disclosure Act

The Home Mortgage Disclosure Act (HMDA) makes information available to the public that helps show how well financial institutions are serving the credit needs of their communities. HMDA identifies possible discriminatory lending patterns and helps regulatory agencies enforce anti-discrimination statutes. HMDA does not prohibit any activity or encourage unsound lending practices.

HMDA requires institutions to compile and disclose data about the applications they receive and the home purchase and home improvement loans they originate or purchase during each calendar year. In general, institutions must report certain data about each application or loan (such as type and amount) and the location of the dwelling to which it relates. If an institution has assets in excess of $30 million, they must also report the race or national origin, gender and income of the applicant or borrower. This particular requirement is optional for banks, thrifts or credit unions that have assets of $30 million or less.

Section 111

Proposals for Change

Proposals for Change

Neither banks nor community groups are happy with CRA, but there is no consensus on how to reform it. What changes are needed to end lending discrimination?

Some claim that CRA has encouraged banks to make more new loans. "I am convinced that thousands of loans have been made throughout the country that would have not been made but for the CRA," says Fed Governor Lawrence Lindsey. Banks have made $35 billion in direct loan commitments to inner cities as a result of CRA, according to the Center for Community Change. Lindsey claims this figure is significant compared to other government programs that assist inner cities. CRA has brought assistance to low- and moderate-income communities during "a period of great shortage of federal dollars, and without the rules and red tape that bedevil so many government efforts," Lindsey says.

Others aren't so sure. Regardless of CRA's benefits, the legislation's "seemingly simple but vague and imprecise charge has caused much consternation," say Griffith L. Garwood and Dolores S. Smith in a *Federal Reserve Bulletin* essay. Although 85 percent of the banks receive an "outstanding" or "satisfactory" CRA rating, "it's clear from available data that CRA has been far from successful in wiping out 'redlining' of poor or minority neighborhoods or racial discrimination in lending," according to an article in *Business Week,* June 29, 1992. Critics contend CRA encourages banks to focus on paperwork and documentation rather than making loans, as reported by the *Washington Post,* Feb. 6, 1993. President Clinton has asked regulators to moderate CRA's paperwork demands and increase lending in low-income neighborhoods.

Community groups and bankers demand changes in CRA, but wish to maintain its flexibility. "Both sides say more explicit guidance on what is expected of lenders is needed. And both fear that excessively rigid standards— explicit formulas for lending, for example — could destroy CRA," says an article from *American Banker,* Aug. 18, 1993. CRA relies on individual banks and local communities to define their own credit needs. Stepping in the middle of this process could limit the expertise of banks and community groups. A fine line must be drawn between guidance and strict mandates. Both groups agree that other financial institutions — credit unions, mortgage bankers and insurance companies — should also have to comply with CRA.

Community groups and bankers disagree on other changes to CRA. Bankers argue that CRA contains penalties for non-compliance, but very few incentives for high CRA ratings. They advocate providing a "safe harbor" from application protests filed with banking regulators if a bank maintains an outstanding CRA record. Small banks argue that they must serve their communities to stay in business; therefore, they should be exempt from CRA. Because CRA imposes substantial costs on banks, bankers support reducing paperwork associated with CRA.

Community groups support stronger CRA enforcement. Specific performance criteria would tighten current subjective CRA ratings. They also support more public involvement in CRA evaluations and requiring banks to disclose information on small business lending. Community groups contend regulators are too lenient with banks, especially since banks are penalized for low CRA ratings only when applying for an expansion, merger or branch opening. Therefore, regulators should expand the scope of sanctions imposed on banks with poor CRA performance.

The Federal Reserve System and other bank regulators are actively improving their administration of CRA. By January 1994 the FFIEC will announce further measures to improve CRA in response to a request by President Clinton.

Section III Readings:

Fettig, David. "In the Light of Public Disclosure, CRA Gains Luster," *fedgazette,* Vol. 5, No. 3, (July 1993), 1, 3-5.

Lindsey, Lawrence B. "Real Progress Without Unintended Consequences," address to the Federal Reserve Bank of Cleveland's Annual Community Reinvestment Forum, Columbus, Ohio. Sept. 24, 1993.

Garwood, Griffith L. and Smith, Dolores S. "The Community Reinvestment Act: Evolution and Current Issues." *Federal Reserve Bulletin.* April 1993, pp. 262-267.

Additional Resources from Advocacy Groups

Write or call the following resources to receive more information on CRA. Select a few in your area; you don't have to send out a mass mailing. A couple outside sources could enhance your understanding of why CRA should be changed or left alone.

Banking Trade Associations

American Bankers Association
Center for Community Development
Donald G. Ogilvie
Executive Vice president
1120 Connecticut Avenue, N.W.
Washington, DC 20036
Tel. 800-872-7747

Independent Bankers
Association of America
Kenneth A. Guenther
Executive Vice President
One Thomas Circle, N.W.
Suite 950
Washington, DC 20005
Tel. 800-422-8439

Regional Office
Bill McDonald
Executive Director
1168 S. Main Street
Box 267
Sauk Centre, MN 56378
Tel. 612-352-6546
800-422-7285

Bank Holding Company
Association of Minnesota
George Howes
Executive Director
6625 Lyndale Ave. S
Suite 609
Richfield, MN 55423
Tel. 612-861-6346

Michigan Bankers Association
Donald A. Booth
Executive Vice President
222 N. Washington Square
Suite 320
Lansing, MI 48933
Tel. 517-485-3600

Independent Bankers of Minnesota
Allen I. Olson
President
2600 Eagan Woods Drive
Suite 200
Eagan, MN 55121
Tel. 612-687-9080

Minnesota Bankers Association
Truman L. Jeffers
Executive Vice President
700 Peavey Building
Minneapolis, MN 55402
Tel. 612-338-7851
Fax. 612-337-5137

Montana Bankers Association
John T. Cadby
Executive Vice President
No. 1 North Last Chance Gulch
Helena, MT 59601
Tel. 406-443-4121

Montana Independent Bankers
Joseph E. Thares Executive Secretary
2030 11th Ave.
Suite 22
Helena, MT 59601
Tel. 406-449-3811

Independent Community
Banks of North Dakota
Arlene Melarvie
Executive Director
601 East Bismarck Expressway
Suite 10, Box 6128
Bismarck, ND 58506
Tel. 701-258-7121
Fax. 701-258-9960
North Dakota Bankers Association
James D. Schlosser
Executive Vice President

120 N. 3rd St
Suite 200, Box 1438
Bismarck, ND 58502
Tel. 701-223-5303

Independent Community Bankers of South Dakota
Maxine Brown
Treasurer
PO Box 399
Freeman, SD 57029
Tel. 605-925-4222
Fax. 605-925-4836

South Dakota Bankers Association
Jeffrey J. Rodman
Executive Vice President
121 W. Missouri
Box 1081
Pierre, SD 57501
Tel. 605-224-1653

Independent Community Bankers Association of Wisconsin
David B. Glomp, CAE
Executive Director
7818 Big Sky Drive
Madison, WI 53719
Tel. 608-833-4229
Fax. 608-833-8114

Wisconsin Bankers Association
Harry J. Argue
Executive Director
One East Main St
Suite 200, Box 1667
Madison, WI 53701
Tel. 608-256-0673
Fax. 608-256-7162

Savings Institutions Leagues

Savings and Community Bankers of America
900 Nineteenth Street, NW
Suite 400
Washington, DC 20006
Tel. 202-857-3100
Fax. 202-296-8716

Michigan League of Savings Institutions
Robert G. Howell
President
200 Washington Square North
Suite 300
Lansing, MI 48933
Tel. 517-371-2200
Fax. 517-371-4081

Minnesota League of Savings & Community Bankers
Richard A. Buendorf
President
625 2nd Avenue South
Suite 303
Minneapolis, MN 55402
Tel. 612-332-4555

Montana League of Savings Institutions
Robert W. Hoene
Secretary-Treasurer
221 Fifth Street
PO Box 503
Helena, MT 59624
Tel. 406-442-3961
Fax: 406-442-3987

South Dakota Savings League
Steve Myers
President
600 Main Avenue
PO Box 98
Brookings, SD 57006
Tel. 605-692-2314

Wisconsin League of Financial Institutions, LTD.
William D. Brouse, CAE

President
20875 Crossroads Circle
Suite 100, Box 1427
Waukesha, WI 53187-1427
Tel. 414-796-2989
Fax: 414-796-2742

Resources for Rural Areas and Minneapolis-St Paul

Students writing papers in rural areas will face a different set of issues than students in urban areas. Both perspectives are very important to the lending discrimination debate. Students near the Minneapolis-St Paul area will have access to a different variety of resources than students living far away from urban areas. Judges will be sensitive to these differences. A student writing an essay in De Smet, South Dakota, will not be expected to interview a St Paul ACORN representative, just as a student writing an essay in Minneapolis will not be expected to interview a rural community banker or FMHA office manager. Essays will be judged according to how students utilize available resources and present organized and concise essays.

Resources in Rural Areas

Farmers Home Administration (FMHA) offices are well informed about the agriculture, housing and community development credit needs of their local districts, largely because they offer credit-related programs. You can investigate how FMHA works with banks and farmers.

County, township or city government offices that allocate Community Development Block Grant funds disbursed from the federal government could explain the status of area credit needs and how local banks participate in community development programs.

Some county government offices may have an economic development office. Check your local directory to see if one is near you.

Contact your local chamber of commerce. Here you will find resources that describe how banking influences the local economy.

Farm Credit Administration
Central Region Office
Dennis L. Barringer
Regional Director
13537 Barrett Parkway Drive
Suite 300
Ballwin, MO 63021-5880
Tel. 314-966-0781

Bloomington Field Office
C. Terry Stevens
2850 Metro Drive
Suite 729
Bloomington, MN
Tel. 612-854-7151

Major Community Organizations in Minneapolis-St Paul

Minnesota Association of Community Organizations for Reform Now (ACORN)
Aaron Dorfman
Head Organizer
ACORN
757 Raymond Ave
Suite 200
St Paul, MN 55114
Phone: 642-9639
Fax: 642-0060

Northside Neighborhood Housing Services
Veronica Davis, Director
1501 Dupont Avenue N
Minneapolis, MN 55401
521-3581

West Side Neighborhood Housing Services
Amy Grayson
127 W Winifred Street
St Paul, MN 55107
292-8710

Southside Neighborhood
Housing Services, Inc.
Nadine Knibb, Housing Specialist
3030 Nicollet Avenue S
Minneapolis, MN 55408
823-0490

Dayton's Bluff Neighborhood
Housing Services Inc.
Jim Erchul, Director
951 E 5th Street
St Paul, MN 55106
774-6995

Home Ownership Center
Chuck Prentice, Director
1619 Dayton Avenue
Suite 204B
St Paul 55104-6206
659-9336
(New organization that provides
training to loan counselors that work
for non-profit housing organizations.
Home Ownership Center works
with financial institutions in
Minneapolis-St Paul.)

The above sources work directly with lenders and provide loan application training. Other neighborhood associations could also provide information about access to banking services in their communities. Housing issues are a top priority for low-to moderate-income neighborhoods in Minneapolis-St Paul.

fedgazette newspaper (also on the Kimberly database, file name: CRA1.art)
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Federal Reserve Bank of Minneapolis

In the light of public disclosure, CRA gains luster But after 15 years, banking industry still takes dim view

By David Fettig
Editor

After years of community reinvestment examinations by federal regulators, bank performance probably didn't improve appreciably, according to one theory.

Then, beginning in July 1990, banks' CRA (Community Reinvestment Act) ratings and evaluations were made public under a new law. Suddenly, the theory goes, banks got religion.

"Disclosure has more power than regulators," says Kenneth Thomas, finance professor at the University of Pennsylvania's Wharton School and a bank consultant. In a book due out in September, Community Reinvestment Performance, Thomas says that many of the roughly 11 percent of below-average rated banks at the time of disclosure were repeat offenders who, for whatever reasons, did not improve their ratings.

Since disclosure, most of the banks who have received higher ratings have moved from "needs improvement" to "satisfactory," according to Thomas, who analyzed over 12,000 public evaluations. Also, of all banks that were examined more than once during that time, 42 percent improved and only 3 percent were downgraded.

"We don't believe we would see this type of significant improvement in banks with below-average CRA ratings if their ratings and evaluations were not made public," Thomas writes. (Similarly, public disclosure of a bank's CAMEL rating, or its measure of strength, would do more to improve the health of the banking industry than much recent legislation, Thomas maintains in an interview—but that's another matter.)

In this issue of the fedgazette, which includes a supplemental directory of the Ninth District's banks and a report on district bank conditions (page 6), bank officials assess the impact of CRA—which was passed in 1977 and enacted in 1978—on the industry, as well as on the operations of particular banks.

Born to ban redlining: A brief history

CRA was enacted in the 1970s, a product of an era of increased consumer regulations that were meant to address reported disparities in bank lending. (See the Executive Column on page 18 for a summary of those regulations.) For CRA, the issue was redlining, or the refusal to lend money to low-income communities, while, at the same time, accepting deposits from those areas.

Financial institutions, the law says, must serve the needs of the communities in which those institutions are chartered. But federal bank laws governing deposit insurance, bank charters and bank mergers—as well as the Bank Holding Company Act of 1956—already addressed such principles. "Thus, the mandate of the CRA was, in many respects, already in place," write Griffith L. Garwood and Dolores S. Smith, Federal Reserve Board economists in the April 1993 Federal Reserve Bulletin.

From the start, the banking industry was worried that a law such as CRA could mean federally controlled credit allocation that would ultimately undermine the safety and soundness of the industry. In part, because of this concern, the act gives few formal guidelines for banks. CRA does not tell a bank how to define its community, how to determine credit needs or how to specify low- to moderate-income neighborhoods.

CRA's inherent vagueness, though frustrating at times for banks, regulators and communities, is one of its saving graces, according to John LaWare, member of the Fed's Board of Governors. "First, every bank is different. Each has its own market focus, structure, lending territory and line-up of products unique to itself," LaWare told a group of Arizona bankers in a 1991 speech. "Second, every community is different. ... Finally, in the context of these differences, regulators cannot possibly know, a priori, what the needs in each and every community are and what the best way of meeting those needs would be."

Throughout the 1980s, community groups grew in number and experience, and challenges to bank acquisitions multiplied—based on discriminatory lending charges. The growing pressure on banks led to a 1989 policy statement from the federal regulators that emphasized the importance of CRA as a day-to-day activity. "[The statement] stressed that the CRA requires an ongoing effort by an institution to ascertain the needs of its entire community, develop products in response, and market them throughout the community," write the Fed's Garwood and Smith.

CRA has continued to attract attention in recent years, especially as the federal regulatory agencies—as well as Congress—address the issue of discriminatory lending based on race.

The law banks love to hate ...

Bankers' complaints about CRA are long-standing: Large bankers reject the implication that without federal prodding they would avoid good business opportunities, small bankers say community reinvestment is their business and CRA is redundant, and most bankers bemoan the time it takes to comply with the law.

A recent banking study suggests that the burden of CRA compliance extends beyond banks to include consumers. In a 1992 survey of 445 banks by Barefoot, Marrinan and Associates, an Indiana-based consulting firm, 18.5 percent of banks have restricted products due to CRA. In dollar terms, the study found that the average bank spends $25,586 per year on CRA compliance.

CRA, along with other consumer regulations, is placing prohibitive costs on banks, according to the report. "Our research found that many banks are declining to offer products due to concerns about high regulatory costs and risks," Barefoot, Marrinan reports. "This reduced supply of products in the marketplace undoubtedly raises prices to consumers."

Ironically, says the firm's president, Jo Ann Barefoot, those reductions in services have occurred mainly in housing-related services, the very areas that CRA and other consumer regulations are meant to address. Where there is regulatory burden, Barefoot says, there is going to be a restriction in the supply of credit. "That seems to be the pattern," she says.

James Schlosser, executive vice president of the North Dakota Bankers Association (NDBA), says he can't name one bank that is doing things differently because of CRA. "The feeling out here is that in smaller communities, CRA is not necessary." The NDBA recently presented its Community Services Awards, its second annual recognition of community involvement by North Dakota banks. This year, 58 banks competed for the awards, twice as many as last year.

Schlosser tells of one North Dakota town where the presidents of the local chamber of commerce, school board, hospital board, VFW Club and other groups are all employees of the local bank. And that's typical of small towns, he says. "We are the number one good citizen," Schlosser says of small-town banks, adding that such involvement ensures that banks are aware of a community's credit needs.

"A bank, unlike any other business, is married to a community," says Barefoot. It should be assumed that a small-town bank is fulfilling its requirements, because "that's what it's there for."

Barefoot, Marrinan's study suggests that the cost of regulatory compliance is greater for smaller banks, but large banks aren't immune to regulatory burden. Sharon O'Neal, community affairs officer for Norwest Bank Minnesota in Minneapolis, heads a department that virtually did not exist just a few years ago. Three employees are dedicated to CRA compliance and four work exclusively to collect and report home mortgage data, according to O'Neal, who monitors CRA compliance at Norwest's 75 banks, as well as directs the Twin Cities' eight-county CRA effort.

"We spend a lot of time right now documenting what I firmly believe is a bank's business and responsibility," O'Neal says, echoing the sentiments of smaller banks.

...gets some positive reviews

But despite the banking industry's concerns about the law, CRA has reportedly accomplished part of its goal. "It's a good start," says former U.S. Sen. William Proxmire from Wisconsin, Senate Banking chairman when CRA was enacted and known as the "father of CRA."

"It's been a good thing, not only for the consumer but for banks themselves," Proxmire says. Banks are making good loans today that they otherwise would have missed, he says.

Proxmire's claim is shared, although perhaps less fervently, by Norwest's O'Neal. "Burdensome or not, CRA has made banks more responsive to communities," she says. "I really believe banks have found value in the whole CRA process." She says that even banks who had special community-based lending programs prior to CRA, have probably discovered that there were members of those communities who weren't aware of those programs. Banks have become more aware of the need for, and benefits of, special marketing efforts, she says.

O'Neal, who prior to her eight-year career at Norwest worked for Twin Cities non-profit groups, proudly discusses the community development programs at Norwest All Norwest banks, which use a detailed flow chart to guide their CRA efforts, meet regularly with focus groups from their communities to help the banks determine the communities' credit needs. "We tie all this back into product and service delivery," she says.

That's the proper reaction to CRA, according to Charles Riesenberg, banking consultant and member of the American Banker Association's subcommittee on community development lending. "It's not, 'How do I get by my next CRA exam?' but 'How do I make community loans?" says Riesenberg, formerly with First Bank System of Minneapolis.

Reisenberg does not believe that CRA has had its intended impact over the years. "Everything's about the same," he says, even though there may be anecdotal evidence that some banks are better community lenders because of CRA.

Most big banks are largely missing the opportunity to make good loans in low- to moderate-income neighborhoods, he maintains. "You don't have a lot of lenders out there, you have a lot of application-takers."

CRA itself is partly to blame, according to Reisenberg, because it encourages banks to become overly concerned with record-keeping. Nine of the 12 assessment factors used to evaluate a bank's CRA performance are related to planning and are largely compliance tasks that can involve extensive documenting, he says. "Filling out forms doesn't make loans. The intent of CRA is to make loans and not fillout paperwork."

Reisenberg contends that, regardless of regulatory pressure, banks should be making more loans to low- and moderate-income neighborhoods because those neighborhoods represent the largest market of untapped business for the financial services industry. "I believe every market has its own opportunities," says Reisenberg, who cited a number of banks in the Twin Cities who are exploiting the business potential of community-based lending.

It may work, but what if we just changed this or ...

Kenneth Thomas, author of Community Reinvestment Performance, states a view shared by many when he assesses the performance of CRA: "It does work, but it can be made more efficient." Thomas says CRA-type regulations may be necessary for other financial institutions, like credit unions or non-bank lenders, an idea that has been recently proposed in Congress.

Many small-town bankers believe a bi-level CRA should be created—with different rules for small and large banks—which would largely relieve them of the documentation and market analysis requirements that they find particularly burdensome and unnecessary.

For Jo Ann Barefoot, CRA would be improved if it provided more specific direction for banks. "I feel strongly that CRA could be clarified further, without going all the way to quantified credit allocation."

Even though in recent years the federal banking regulators have refined CRA to provide more guidance on how banks can comply with the law, few observers expect radical changes from the regulators or Congress. Besides, many believe that CRA, in its present form, is the best method to accomplish the goal of increased community reinvestment. In his speech before the Arizona bankers, Fed Governor LaWare reaffirms the benefits of CRA's "uncertainties:"

"CRA must be viewed as a dynamic process. There is no beginning point or ending point for an ongoing bank's CRA program. As community needs or a bank's structure or market strategy change, so must its CRA program.

"In that regard, the uncertainties of CRA may in fact be its strength. It forces us all to continuously review changes in the environment and take action based on that review."

Regardless of CRA, bank says business lending is good business

Following eight years of commercial lending with First Bank System of Montana, Leslie Jensen recently became director of the Missoula Community Business Incubator (MCBI). She still makes decisions on loans, only now they are usually much smaller ... and riskier.

She also finds herself sitting on the other side of the loan officer's desk at the local bank, trying to convince bankers to guarantee the funds and the time to maintain a portfolio of start-up business loans averaging $10,000 over five years.

In each role, Jensen has seen the positive and negative impacts of the Community Reinvestment Act (CRA), the 1977 law that requires banks to lend to all sectors of their communities. "I've had a good look at CRA from both sides of the fence," Jensen says. "And I often find myself defending banks."

The requirement to do business with sectors of the community that may prove to be a credit risk, along with the requirement to operate a safe and sound bank, is akin to a regulatory Catch-22, Jensen says. "What other for-profit company has those same types of federally mandated requirements?"

On the other hand, banks have a special place in this country's economy, Jensen says; after all, what other business is backed by the full faith and credit of the government? Also, she acknowledges that without CRA, an endeavor like the Missoula incubator might not receive financial support. "We are filling a gap that banks can't fill, but we still need their support," she says. That's where First Security Bank of Missoula comes in, according to Jensen.

While the MCBI guarantees all or a portion of its loans, which cannot exceed $15,000, it still needs the advisory and administrative expertise of a bank. With the loans guaranteed by MCBI, which is funded by a $250,000 state grant, First Security assumes no financial risk, Jensen says, but that doesn't mean the loans are trouble-free. "They're putting a lot of time and attention on loans where they won't make a lot of money."

William Bouchee, president of First Security, says his bank's involvement with MCBI and other local business development groups is part of his bank's philosophy—regardless of CRA. "We support all economic development in town," he says. "We want to reinvest in our community."

That notion is seconded by the director of the local Women's Economic Development Corp. (WEDCO), Kelly Rosenleaf. She says that other banks were not as receptive to WEDCO, which is five years old, in its early days. "They do a lot of business lending anyway," she says of First Security. "They have a very active commercial lending department."

Much like MCBI, WEDCO is a micro-enterprise network that guarantees a portion of its loans, which average about $9,500. WEDCO also offers business consulting services, and First Security has participated in the group's training sessions.

And that participation, Bouchee says, is not a result of CRA. "We have a hard time understanding a need for it here," Bouchee says of the law, which was originally written to address problems of redlining, or restrictive lending practices, in larger cities. He says redlining, or the current focus on fair lending due to race discrimination, are not pertinent issues to Missoula, because those are not issues in the community.

Among other things, CRA requires banks to know the credit needs of its community, but Bouchee says Missoula is small enough, about 43,000, that a community bank can determine those needs through its natural involvement in the community.

Bouchee says his bank is committed to business lending and to business development because he sees it as a valuable niche. And that is the proper role of the bank, Jensen says. "Banks are not really in the field of economic development, but we are," she says, explaining the need for the partnership between banks and groups such as MCBI.

—David Fettig

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Community reinvestment is a way of life, not a law, says small-town bank

For Root River State Bank of Chatfield, Minn., like other small-town banks, community involvement takes many shapes:

- At virtually any social function in Chatfield, right next to the coffee pot or at the end of a buffet line, are a pile of napkins emblazoned with "Root River State Bank."
- During June, a man from a nearby boarding house routinely comes to enjoy cookies and milk in the afternoon (sponsored by the bank in recognition of national dairy month and the local dairy industry), and promptly takes a nap on the bank's lobby couch.
- One day in early June, Charles Johnson Jr., executive vice president of Root River State Bank, distributed personalized key chains to graduates at the local high school. Later that day, he spoke briefly with a group of touring first-graders, addressing the teachers and some of the students by name.

What does all that have to do with the Community Reinvestment Act, the 1977 law meant to spur lending to all sectors of a community? At first glance, nothing. Supplying napkins and serving milk won't garner a high CRA rating from federal examiners, but bank executives and Chatfield residents use those examples to underscore what small-town banks have been claiming for years: That involvement in a community and knowledge of its residents are synonymous with small-town banking.

"The bank does not succeed in a community such as this if we're not doing these things anyway," Root River State Bank's Johnson says about CRA's requirements to prove that the bank is involved in the community and, hence, aware of Chatfield's credit needs.

To document such proof, Johnson and the bank's 16 employees save newspaper clippings, brochures, advertisements, church bulletins, correspondence and any other evidence of their participation in civic affairs. Also, Johnson has each employee keep a CRA diary in which they record every meeting, luncheon speech or volunteer activity that may have any bearing on CRA. Those diaries are then presented to examiners along with the other evidence of a bank's community outreach.

"I know it's an examiner's job," Johnson says about the CRA requirements. "But when an examiner asks for proof, I'm almost offended." However, he concedes: "You've got to play the game, and if you don't you get burned. So we document."

One difference between pre- and post-CRA banking for a small-town bank like Root River, Johnson says, is that now the bank must dedicate an employee to regulatory compliance. At Root River, that employee is Lynden Dirksen, assistant vice president, who also manages the bank's operations and data processing.

"We had CRA before it was ever enacted," says Dirksen, who has worked at Root River for 15 years and says he knows about 80 percent of the bank's customers by sight.

He's also become familiar with the bank's examiners. "We've never had any knock-down, drag-out fights," Dirksen says of the compliance exams, because he says the bank is always prepared. "If we weren't prepared, [the exam] would be a dreaded event."

As part of their effort to determine a bank's CRA compliance, bank examiners visit with members of the community. One Chatfield resident, the local druggist David Stemp, says the bank has had an important relationship with Main Street retailers over the years. Stemp would know, he has run Chatfield's local drugstore for 25 years, and it has been in the family for over 100 years. Recently, the bank participated in financing a major renovation of Chatfield's Main Street.

Stemp says Charles Johnson Jr., and his father, Charles Sr., are participants in nearly every civic committee or town project. Charles Sr. is president of the $45 million asset Root River State Bank, as well as president of Johnson Bancshares, a bank holding company that owns Root River. Charles Sr. is also president of the First State Bank in nearby Fountain. The Fountain bank, with $26 million in assets, was established by Charles Sr.'s father in 1901.

Chatfield's two largest manufacturers, Tuohy Furniture and AFC Manufacturing, both employ about 150 workers, and while they may have outgrown Root River for certain financial services, both companies still do some of their banking locally, according to Dan Hollerman, quality control expert at Tuohy.

Hollerman says it is important for a small town like Chatfield to have a local source of credit. For example, he says that the bank—through a cooperative effort with other independent banks—is arranging to provide home financing to Chatfield residents that it would otherwise be unable to provide. He knows about the program, Hollerman says, because he may be looking for a loan himself.

And Faye Wiskow, business owner, former city council member and lifelong resident of Chatfield, credits the bank's involvement in city government and school affairs. She also says Root River State Bank's connection to Fountain may pay dividends to Chatfield in the form of tourist dollars. The popularity of a major bicycle trail at Fountain has already meant some spillover into Chatfield, but a proposed extension of the trail to Chatfield is expected to create a minor explosion in the local tourist industry.

At the regular board meetings of the First State Bank in Fountain, there is usually at least one loan proposal relating to the bike trail says Charles Jr., whose father is an avid bicycler and promoter of the Fountain trail system. Loans for retail shops, restaurants, bike-related services, and bed and breakfasts are the most common requests, according to Charles Jr.

Wiskow, Stemp and Hollerman all hope that an extension of the bike trail would encourage the opening of a motel in Chatfield. Currently, says Hollerman, if Tuohy Furniture has to house business associates, it must do so in nearby Rochester or in other neighboring towns.

In the end, the three Chatfield residents say that Root River State Bank's involvement in the community is done quietly, like other civic-minded businesses in town. "We all know what they do," Hollerman says.

Which brings up a somewhat galling point for Charles Johnson Jr. He says that CRA's requirements to document the bank's activity is against his nature. "It's like tooting our own horn. I'd rather work quietly, knowing that we're doing our job." Instead of considering the merits of a particular civic project or volunteer effort and deciding independently whether he or the bank should get involved, Johnson says that CRA is always in the back of his mind, sometimes influencing his decision.

Lifting the bulging manila file before him, he says: "The whole idea of this file is self-justification, and I have a problem with that."

—David Fettig

Real Progress Without Unintended Consequences
Address by
Lawrence B. Lindsey
to
The Federal Reserve Bank of Cleveland's
Annual Community Reinvestment Forum
Columbus, Ohio
September 24, 1993

When President Clinton announced last Summer that he wanted the financial regulatory agencies to work together to reduce the burden of and improve the results from the Community Reinvestment Act (CRA), he indicated to the nation's banks and consumers that CRA could undergo a sea change. The President wanted to focus on three types of community reinvestment activities — lending to low and moderate income individuals, small businesses and farms; investment in low and moderate income neighborhoods; and the provision of banking services to low and moderate income neighborhoods. His stated desire was to create "...more objective, performance based CRA assessment standards that minimize the compliance burden on financial institutions while stimulating improved CRA performance."

I applaud the President's timely and important initiative and am working with my fellow Board members and colleagues at the other agencies to fulfill the vision that President Clinton has articulated. However, I must insert one note of caution. No plan, however well created and executed, can take the place of prudent and consistent reason and judgment in the lending process. Fair lending is not initiated by governmental agencies but by individual lenders across the nation.

From its inception, the Community Reinvestment Act was deliberately vague. Congress wisely chose to avoid even the appearance of prescribing the allocation of credit. CRA, as legislatively defined, required financial institutions to demonstrate that their deposit facilities served the convenience and needs of their communities including the "continuing and affirmative obligation to help meet the credit needs of the local communities in which they are chartered". Regulator were required to “encourage such institutions to help meet the credit needs of the local communities in which they are chartered consistent with the safe and sound operation of such institutions”.

In recent years, CRA has come under attack for its apparent failure to fully meet its stated objectives. This criticism is not without basis. Inner cities still suffer from disinvestment. Large sections of the population do not have ready access to a bank branch. Statistical studies indicate that racially based differences in mortgage approval rates do exist, even after taking economic variables into consideration.

When all is said and done however, the question still remains—will more specific guidance by Congress and/or the regulators in fact generate the desired result—equal access to credit for all creditworthy Americans? Before looking forward to see if we can answer that question, let us first look back to the early days of our nation for some possible guidance.

Although we may like to think otherwise, the CRA concept is not a new one. The proper role of banks in their communities has been a controversial subject since the start of our country. In Philadelphia, the Bank of North America was chartered in 1782 by some of our nation's leading citizens including Alexander Hamilton and Benjamin Franklin. The story of their experience is an illustrative one.

The Bank of North America focused primarily on financing commerce through the thriving port of Philadelphia. Pennsylvania's farmers, who dominated the state legislature, felt that the bank was not lending enough to them. They succeeded in their drive to repeal the bank's existing charter and replace it with a much more restrictive one. This was truly a Phyrric victory. The bank's fortunes declined, as did banking services. The result was a prolonged slump in economic activity in Pennsylvania, a slump which also adversely impacted the farming community.

I think that there are some important lessons to be drawn from this early experience. First, political supervision of bank lending practices is nothing new, and may be an inevitable part of a democratic society. That may not comport well with the theoretical model of a completely free financial services industry, but then neither do other aspects of banking including federal deposit insurance and lending at the discount window. The supervision and regulation function certainly provides a public good, from which banks benefit, by providing a reassurance to depositors. For better or worse, political oversight of bank lending practices is an inevitable extension of these other aspects of government regulation of banking.

The second lesson of history is that moving in a purely political direction of banking, or heavy handed a edit allocation, is not only bad for banking, it is harmful to society as a whole. This was of course the historical result in Philadelphia. In more recent times, the effects of misguided credit allocation were evident in the economies of Eastern Europe, a region whose patterns of development we all agree would be foolish to emulate.

Thus, CRA is part of a longstanding balance between the need for some political oversight of the lending process, and the problems which result if such oversight becomes excessive. However, we must bear in mind that because political oversight is at best a blunt instrument, striking an appropriate balance between constructive oversight and overburdening regulation has always been a difficult task. In recent years, that oversight has escalated as it increasingly appeared that discrimination has continued to permeate the lending process. The issue of mortgage discrimination burst to the forefront when CRA ratings and HMDA data were made public in the late 1980's. The heat was turned up again as recent events in our urban areas as well as a new activist Administration have further highlighted the dramatic need for investment in communities across the nation.

Discrimination tears at the fabric of our democratic society. It also tears at the fabric of our faith in capitalism and the market. One of the great advantages of the market is that it is supposed to be color blind. If that turns out not to be the case, then the foundations of our economic system as well as our political system-are at risk. So discrimination is a fight that we as a society must win. It is for & is reason that I see fair lending issues as having the greatest potential for further legislative and regulatory activity—activity which may have at its root the increasing use of statistics.

Statistics have played a major role in our consideration of the mortgage discrimination problem of late. Their role as an enforcement tool is just now beginning, and is likely to increase dramatically in the years ahead.

But as a long time micro empiricist, I am well aware that statistics can play only a supporting role in our quest For understanding the limitations of statistical analysis may be key to solving the underlying problem and establishing truly equal credit opportunities for all Americans. While statistical analysis can highlight inequity, it cannot eliminate it. That must be done on an individual basis, on the front lines, at the level of the applicant and the loan officer.

However, the use of statistics can, and has, provided a baseline from which to start. Take for instance, the use of HMDA data. While community activists, bankers, regulators and legislators are all familiar with the limitations of the HMDA data, the HMDA data do indicate that there is a racially based problem in mortgage lending.

Having said that, two important qualifications are in order. First, it is widely acknowledged that the HMDA data exaggerate the extent to which approval rates differ for racial reasons. When economic factors other than income are incorporated into the analysis of HMDA data, the disparity between black and white approval rates is sharply reduced.

Second, the evidence of race-based differences in loan approvals is overwhelrningly of a statistical nature, based on racial averages. It is very hard to document by examining specific loan applications, such as during the bank examination process. Accepting this fact is difficult for those who seek simple, straight-forward explanations
for the racial disparities. It's always easier when there's a smoking gun and an identifiable culprit.

Last fall, to clarify the HMDA data, the Federal Reserve Bank of Boston ran what is certainly the most comprehensive statistical analysis of lending patterns by race that has ever been conducted. That study found that what I would call "old style" discrimination did not exist That is, clearly qualified applicants of any race were approved for loans and clearly unqualified applicants of any race were rejected. The days when members of minority groups who meet all of a bank's criteria for lending are rejected anyway, seem to be gone. I believe that is why bankers believe so strongly that they do not discriminate.

However, what the study also found was that a careful statistical comparison of applicants who were less than ideal indicated that imperfect white applicants were more likely to be approved than imperfect black applicants. Three types of explanations for this have been advanced. First, some have argued that the results are proof that racism still exists in our society and in the banking industry. From a statistical point of view, there is no way that this hypothesis can really be tested. It may be true. My own judgment is that while some racism may exist, it is probably not the dominant factor in bank decision making. The institutions in question all have stated policies against discriminatory practices, and the extent of discrimination found, which affects roughly 7 out of every 100 minority applicants, does not comport with racism as dominating the process. I say that with the understanding that any amount of discrimination is totally unacceptable.

The second hypothesis is that there is no racism in the process, that in fact the banks have gotten their lending practices about right. What is missing from the Boston study is a careful look at the long term default risks on these loans. It is true that the Boston study did not go into a detailed examination of the actual loan files to see if some other explanation for rejection existed. Where this has been done, some of the disparate rejection rate has been explained. But, ultimately this hypothesis, like the racism hypothesis, cannot be statistically tested. We cannot tell today what the ultimate outcome of the loans we make today will be. Nor will we ever be able to tell what the hypothetical performance of rejected loans would have been. So, like the first hypothesis, I accept that this one might well be the case, but that the evidence before me today does not support it.

The third hypothesis is that some racially disparate loan practices are occurring in spite of bank policies to the contrary. This hypothesis not only comports with the Boston findings, it also suggests that relatively minor adjustments in institutional behavior will be appropriate remedies. The Federal Reserve Bank of Boston has recently put out a pamphlet on these remedies called Closing the Gap: A Guide to Equal Opportunity Lending which I commend as important reading for all individuals in the financial services industry.

Let me also stress that as long as behavior exists which appears outrageous to reasonable individuals, the threat of legislative and/or regulatory action, with all of its attendant burdens remains likely. Banks have a responsibility not only to end the practice of discrimination, but end the appearance that discrimination is occurring as well. As long as large numbers of minority customers remain dissatisfied with the treatment they receive, greater regulation remains a likely prospect. Or, as President Jordan of the Federal Reserve Bank of Cleveland has argued, "This problem is not solved until everyone agrees it is solved."

The prospective regulatory burden which might result from not solving this problem is potentially enormous. Left unchecked, a total reliance on statistics in credit enforcement will ultimately lead to a complete replacement of bank judgment and reason regarding loan approval with statistical rules. I fear that in some instances, the use of statistics to establish discrimination may go too far. At the Federal Reserve we are using computer based statistical models as a part of our examination process. However, these models are only used to select particular loan applications to examine more closely. The statistical models in and of themselves will not, and should not, be used to determine whether discrimination exists. Instead, the computer will select individual matched pairs of actual applications to be examined. We believe that this will improve the efficiency of the examination process by reducing randomness in selecting applications to be examined.

The potential overuse and abuse of statistics in this area threatens the imposition of a burden in at least two ways. First, the use of statistical models as the sole criteria especially when the details of such models are unknown to the banks being examined, means that no bank can know what rules it actually has to comply with. It would be like replacing the speed limit on our nation's highways with some computer determined "Conditions Adjusted Velocity" formula in order to enforce traffic laws and not tell motorists what the Conditions Adjusted Velocity formula was. Laws can only work if people know what they have to do to obey them.

Second, the likely result of statistics based examination of loan approvals is statistics based approval of loans. This, in turn is likely to work against individuals who do not meet the "normal criterion" of a one-size-fits-all statistical rule. One need only look at the historic performance of the secondary market to see that minorities and other disadvantaged groups find themselves only further disadvantaged by such inflexible practices.

Statistics, however, are not only used by regulators. They also play a role in our nation's media. Statistical analysis when done well is an infinitely complicated and painstaking procedure. But when statistics are run on the evening news or in headlines across the country they are frequently reduced to the lowest possible common denominator. For example, in the Boston study's sample, roughly 7 out of every 100 minority applicants for a mortgage are rejected for reasons that cannot be explained by factors other than the individual's race or the racial composition of the neighborhood into which the applicant is buying. To the average editor or producer, 7 out of 100 may not be a sufficiently dramatic statistic—it won't give legs to the story. So, the most widely reported number from the Boston Study indicated that a black applicant was 60 percent more likely to be turned down for a mortgage than a comparable white applicant. Both statistics are absolutely correct with respect to the study. However, the 60 percent statistic gives little indication to applicants of what their actual chances of acceptance are. As more than 70 percent of minority applications are approved, a 60 percent higher rate of rejection would seem to needlessly discourage potential applicants.

Another area where the media do not appropriately portray reality involves the economic status of African-Americans, and particularly the change in that status in the past decade. This is a very important subject to address because both banking in general, and mortgage lending in particular, are profit driven businesses. Lending will take place where there is money to be made, or more precisely, where it is perceived than there is money to be made. Unfortunately, there is a widespread myth, reinforced by the media, that the great majority of blacks live in poverty, and that little progress has been made recently in ending that situation.

The facts could not be more different. During the 1980s tremendous gains were made by the great majority of black families. Between 1981 and 1990, median black family income rose 12.3 percent after controlling-for inflation. By contrast, the income for the median white family rose 9.2 percent. Black income growth particularly outpaced white income growth among those families most likely to be first time homebuyers. After controlling for family size, the top quintile of black families saw their real income rise 28 percent during the 1980s. The second quintile of black families enjoyed a 19 percent gain. The proportion of black families living it suburban counties rose by a third and the proportion of black families earning real incomes over $50,000 rose by 42 percent.

Not only that, but the situation is likely to get better in the next generation due to significant gains in black educational achievement. During the 1980s, the SAT scores of black children rose 23 points in math and 20 points on the verbal test, compared with essentially stagnant scores for white students. The black dropout rate from high school fell from 18 percent to 13 percent over the same period. These facts augur well for future black income gains.

So it cannot only be left to bankers to eliminate both the practice and the perception of discrimination. All parties involved in this volatile and emotional issue must practice in their professions what physicians, in taking the Hippocratic oath, practice in theirs --above all do no harm. Above all, this means that any regulatory or legislative "fix" must be carefully and thoroughly considered. The potential for pernicious, albeit unintended, consequences is great.

In proposing the CRA review, President Clinton has rightly noted that it is performance not paperwork which indicates whether a financial institution is meeting the needs of its entire community. I agree with the Comptroller of the Currency, Eugene Ludwig, when he testified last summer that "... between a rigid system of numerical targets and the system we have today, there is considerable room for improvement". However, the devil is always in the details. We must be ever careful to not put into motion the law of unintended consequences. It is often well intentioned legislation or regulatory improvements which can exact a very high and unintended cost

Consider for example, the legislation and organization which created the secondary mortgage market in this country. Fannie Mae has, by most accounts, been quite successful at its main mission: to provide liquidity to the mortgage market by creating easily traded mortgage backed financial instruments. But a price has been paid for such liquidity. Increasingly, banks have moved to standardized lending practices as they have seen their mortgage business evolve into that of a broker, rather than a conventional lender. It is no longer crucial that banks know their customer, but rather that their customers fit a predetermined profile. Credit evaluation is based increasingly on quantitative criteria, rather than qualitative judgments.

If you're a one-size-fits-all customer, you have probably benefited greatly from this approach. If you are one of those people who is different from the norm, as I mentioned earlier, you may have been inadvertently left out. Let me say that Fannie Mae recognizes this problem and is striving to make sure its guidelines take a broader array of applicants into account.

Yet another example of unintended consequences arose last year when the Federal regulatory agencies, prompted by Congressional action in the FDIC Improvement Act, considered establishing maximum loan-to-value ratios for single family housing lending. I strongly opposed such a move because it would have further exacerbated the difficulty of obtaining a loan for individuals who do not meet the normal criteria. I was particularly concerned about the impact of this on mortgage lending to low and moderate income families who have limited funds to cover closing costs, let alone provide a major downpayment. In fact, the fewer such rules we have, the easier it will be for non-traditional borrowers, who are often members of minority groups, to obtain credit.

As I've traveled around the country I've seen numerous other examples of well intentioned government policies that are making access to housing more difficult, particularly for minority groups. For example, consider the cap on the size of loans eligible for FHA insurance. As a result of these limits, FHA loans are virtually unavailable in New York City, where the overwhelming majority of housing costs more than the limits allow. Nearly every coordinator for the Neighborhood Housing Services (a national housing and redevelopment organization) I have spoken with felt limited by the Davis-Bacon legislation which drives up the cost of housing construction and limits job opportunities for inner city residents. In city after city, rules regarding the taxes owed on vacant land or on abandoned buildings are inhibiting the development of low and moderate income housing and the development of communities.

Inner cities and other hard-to-value areas are also particularly starved for development funds in part because of appraisal requirements imposed by law. The whole appraisal area is, at best, an art not a science. This is particularly true in areas where communities are changing. Yet the Congress has mandated costly appraisal requirements which are retarding community development. We at the Fed exercised the maximum latitude the law allows us in setting a $100,000 threshold on formal appraisal requirements and are seeking comment on raising this threshold further to $250,000.

In addition to community redevelopment being constrained by the unintended consequences of many different pieces of legislation, we cannot overlook the dramatic changes that have been made in the nature of bank regulation and their effect on banks' available capital. By international agreement, our banks are now judged on the amount of capital they have relative to their outstanding loans. For a well capitalized institution this means that they must have at least 6 cents in so-called Tier One capital for every $1 in loans they make. The only way to increase loans is to increase capital. There are two ways to increase capital: after-tax profits, which increase capital dollar for dollar, and new stock offerings. These new stock offerings, in turn, depend upon bank profitability. Every dollar in unnecessary costs imposed on banks means $16 less in loans that the bank is able to make.

Of course, this does not mean that we must do everything possible to maximize bank profits. Far from it. Regulation to protect consumers and depositors and to enforce existing regulation is essential. But our regulation must be cost effective. Excessive regulation, by diminishing bank capital, and therefore by a multiplier effect, the amount of funds that banks can lend, could end up hurting the intended beneficiary of the regulation. We must be committed to making regulation as cost effective as possible.

Let me revist my initial question. Will more specific guidance by Congress and/or the regulators in fact generate the desired result—equal access to credit for all creditworthy Americans? Perhaps. But certainly not without a price. National solutions to local problems generally cost more in time, resources and money than local solutions to local problems. But the divisive problem of discrimination cannot be left to idle. As a nation, we cannot move forward if the specter of racism is not removed—at any price.

minority business. and other community revitalization projects.

Reserve Banks help facilitate the broad-based offering of credit through conferences for bankers on topics such as barriers faced by minority borrowers. steps to ensure that credit is offered on an equitable basis. ways of participating in economic development programs. and credit issues affecting Native Americans. Reserve Banks also provide technical assistance. helping institutions to create community development corporations (CDCs) and multibank lending consortiums and. in the case of institutions with unsatisfactory CRA rating, helping them to strengthen their CRA program. Reserve Banks publish descriptions of CDCs. limited partnerships. and other community development projects in which bank holding companies have been allowed to invest. They prepare profiles that identify key community- and economic development needs and describe resource organizations in major communities.

For example. the Federal Reserve Banks of San Francisco and Philadelphia have produced community profiles used by local financial institutions to address specific issues and projects. The Federal Reserve Bank of Boston has developed a training curriculum on community-development finance for bankers. Reserve Banks also publish a variety of other brochures and manuals that assist lenders in community development activities. Their community affairs newsletters have a combined circulation of more than 40,000.

Other federal banking agencies also have community affairs programs. The OCC's Community Development Division. for instance. oversees CDC and investment programs and approves applications by national banks to invest in CDCs in accordance with the National Bank Act and its interpretations. The FDIC has a community affairs program that, like the Federal Reserve's. has a regional presence.

INDUSTRY INITIATIVE

The CRA has stimulated an abundance of activity by financial institutions and others. For example. in late 1992 the American Bankers Association established a Center for Community Development whose primary mission is to provide information and technical assistance to its members The center has already published an educational guide, and in 1993 it expects to sponsor workshops and publish a compendium of contacts at community lending agencies and organizations. The center is also involved in credit counseling outreach. offering camera-ready copies of a five-part series of brochures on such issues as home buying and credit rights for member banks to publish and distribute in their communities

Two recent surveys illustrate the banking industry's efforts. In a survey of banks. thrifts. and holding companies. the Consumer Bankers Association found that roughly 90 percent of its respondents have programs that target purchase-money lending for low- to moderate-income housing Nearly 95 percent of the programs include mortgage products with flexible requirements for down payment, loan-to-value ratios, and debt-to-income ratios designed to make home financing more available and affordable.[15]

[15] Consumer Bankers Associalion. Affordable Mortgage Survey. A Survey of Bank Mortgage Programs as of June 30, 1992
(Washington: CBA. 1992). pp. 2,4.

And in late 1992. the OCC announced the results of a survey to which nearly 55 percent of all national banks responded. A majority of the respondents engaged in community development lending and financed low- to moderate-income housing, small businesses, and small farms. The type of lending tended to differ according to their asset size For instance, among the largest banks (assets of more than $l billion). 86 percent focused-on low- to moderate-income housing. whereas among the smallest banks (assets of less than $100 million). 72 percent reported making small-farm loans.

Depository institutions have access to various forms of assistance to support their CRA activities. For example. the Federal Home Loan Bank System offers two loan programs to its membership of savings banks, savings and loan associations, and banks. It advances funds or subsidizes below market-rate loans originated for low- to moderate income families and for businesses in low- to moderate-income neighborhoods. Its Community Investment Program provides home lending funds to projects aimed at individuals with incomes of up to 115 percent of an area's median income: an Affordable Housing Program provides home lend-

♦

determining the adequacy of CRA performance

Many lenders express frustration at the business of translating the broad mission of the CRA into specific actions. To be sure, most lenders would oppose overt credit allocation and would resist being told what products to offer. or in what volume. or on what terms, or to whom. But many want to know. from the start. exactly what the "right" activities might be for CRA performance and what it takes to get an outstanding" CRA rating Examiners who judge performance. and community groups who evaluate institutions, likewise would be more comfortable with greater certainty.

The problem lies in preserving flexibility and providing precision at the same time. The CRA can be criticized for its ambiguities. but that same "flaw" allows for variations by institutions in meeting their responsibilities under the law. Over the years. the regulators have emphasized their position that no single community reinvestment program is perfect for ever institution Financial institutions can design CRA programs that fit their own business orientation and the special needs of their community Still. the agencies have offered extensive guidance on the CRA—policy statements. examination procedures, assessment factors considered in evaluations, elements of successful CRA programs. and advice through community affairs programs Throughout. they have emphasized flexibility. seeking to give detailed guidance without imposing specific mandates.

Initially the industry wanted flexible CRA rules out of concern about regulatory credit allocation. The industry argued that neither the law nor the regulations should set minimums or mandate the types of loans an institution must offer. Increasingly. however. depository institutions and trade groups have asked for more precise rules. Recent interest in community development banks has even brought suggestions that institutions be allowed to meet their CRA obligations by specified investments in such institutions

The State of New York. which has a community reinvestment law much like the federal law. is considering a proposal that would identify specific activities for which depository institutions covered by the state's statute could earn CRA "credit” The system would require institutions to establish investment targets for the CRA. measure these investments in relation to the institution's assets, and tie CRA ratings to minimum specified amounts of such investments[18]

Moving toward a cafeteria-style menu of value weighted. “approved'' CRA activities—in a manner similar to what New York has proposed—has some appeal in that it would offer certainty. Potentially it also could increase desirable CRA-related activities in local communities. At the same time, creating such a list would inevitably transfer decisionmaking in some measure from an institution to the government. As it stands. the CRA's broad standard allows each depository institution to be creative in meeting credit needs within its lending community. The incentive to offer innovative service may be lost if institutions find it necessary to choose between engaging in services they know will earn them CRA credit and taking a chance on something that does not quite fit into a preapproved pigeonhole. Also, the CRA is meant to encourage institutions to meet the credit needs of their entire community. Communities could be left with unmet credit needs if institutions were able to fulfill their total CRA responsibilities by a single CRA-related action, such as a passive investment in one community development organization in a sole low- to moderate- income neighborhood

Paperwork Burden

Among lenders. and even community representatives. one major source of dissatisfaction with the CRA is the paperwork that they believe the agencies require to demonstrate an institution's record of performance Small institutions. in particular, complain that the documentation provided to agency examiners is costly and unnecessary. Recent studies by trade groups among banks of all sizes point to the CRA as imposing substantial compliance costs. In a June I992 study by the American Bankers Association on the sources of regulatory burden, the CRA topped the list as the most significant. A study by the Independent Bankers Association of America estimated that compliance with the CRA cost about $1 billion annually out of a total $3 billion for selected laws

Some community groups, too, criticize regulators for elevating form over substance More attention is focused on- documenting community outreach. they say. than on whether an institution actually is making loans While they may have a common complaint with some in the industry, however. their suggested correction for the problem is likely to be more mandated lending—a result most in the industry would oppose

The technical “hard paper'' burden of the CRA is in fact rather small: a CRA statement listing the types of loans the institution is willing to make: a map showing the boundaries of the local communities it serves: evidence (usually a notation in the minutes) that the board of directors has reviewed the statement at least annually: a lobby notice describing how the public can comment on the institution's CRA performance: and a file with its CRA statement. agency assessment. and public comments available for inspection All are modest requirements. but they do not, of

[18] The stale s community rcinvestmenl law is in N Y. Banking Law § 28-b (McKinney 1990) The proposal for earning CRA credits is in New York State Banlcing Department. “Proposed Comprehensive Policy Statement Relating lo the New York State Community Reinvestment Act: Requesl for Public Comment' (September 9, 1992)

course, reflect the true extent of the documentation actually needed Other paperwork is unavoidable The statute calls for the public CRA assessments to contain facts and data" to support the examiner's conclusions. and at a practical matter most of these “facts and data'' earn come only From the institution

One of the twelve assessment factors for CRA performance requires the examiner to evaluate the geographic distribution of the institution's credit extensions. applications. and credit denials After considerable debate on this point. the FFIEC in December 1991 issued a policy that strongly encourages institutions to analyze the geographic distribution of their major product lines as part of their CRA planning process Institutions also are encouraged to collect lending data and correlate them with the relevant demographic facts relating to the institution's community The board of directors and senior management are expected to review the analyses in setting and evaluating the institution’s CRA program Understandably. this geographic tracking also has contributed to complaints about CRA paperwork.

In June 1992 the FFIEC issued examination procedures to address the outcry about unnecessary paperwork burden. The revised procedures emphasize that examiners should focus on performance in meeting credit needs, not on process, and that an institution's size has a bearing on how formal the proof of performance needs to be Regarding geographic analysis. the FFIEC stated that the extent and sophistication of analyses expected by the agencies will depend on the size and location of the institution. What may be required for a large institution to track its loans, for instance. is not required for a small institution. which could be served by a more informal system

Any well-conceived, ongoing CRA process will involve normal business documentation. To recognize the credit needs in their communities. as well as to know whether they are meeting those needs, institutions must have a process in place that provides relevant information. This is certainly the case for most large institutions, especially those with widespread branch network. Smaller institutions, too, need to demonstrate performance, but their documentation may not have-to be as sophisticated or extensive

Despite agency efforts ~o contain the problem of CRA paperwork. it remains troubling Through the FFIEC. the federal regulators continue to evaluate the paperwork issue as well as other CRA enforcement matters to see whether clarification or additional change is warranted

Exempting Small Institutions

The agencies generally have tried to be sensitive to the complaints of small institutions that they are disproportionately affected by the CRA. The institutions say they must serve the needs of their entire community just to exist as viable businesses. and that. therefore. CRA requirements are unnecessary for them Exemptions for small institutions are not a novel concept. For example. a depository institution's size determines whether it is covered by HMDA and. if it is covered. the data that it must report

Community groups do not believe that small institutions necessarily meet the credit needs of their communities as a matter of course. and they point to the low loan-to-deposit ratios of some small banks.[19] They say small institutions need to do more. not

[19] mEC. Stu~l on Regulatory Burdcn (Washington: FFIEC. 199'). Appendix A. p. '

less, to comply with the CRA, and therefore they strongly oppose proposals for a small-institution exemption and for selfcertification.

Apparently. the size of an institution is not a good indicator of CRA performance Most institutions in all asset-size categories received ' outstanding'' or 'satisfactory'' ratings in examinations in the first three quarters of 1992 (table 1).

Some members of the Congress have taken up the proposal to exempt small institutions from the CRA. One bill would exempt an institution from the CRA if it is in a small town. has assets (aggregated with the assets of its holding company) of $75 million or less. and can show that its loans come to 50 percent or more of deposits Such a proposal would exempt about one-fourth of the 1').000 institutions supervised by the Federal Reserve. the FDlC. and the OCC. but it would maintain CRA coverage of almost all banking assets. Of the total group's $3.6 trillion in assets. the banks that could be exempted account for about 3 percent. or $107 billion.

Another proposal would allow institutions with total assets of $250 million or less to certify their compliance with the CRA—provided. among other things, that they have a ''satisfactory'' or higher rating and remain in compliance-with the Equal Credit Opportunity Act. Self-certification would take the place of agency examinations. The regulators would be required to examine an institution only in response to an allegation that it was not meeting the credit needs of its entire community. If banks with assets of up to $250 million were exempted from the CRA. as many as 87 percent of all financial institutions in the country could be excluded. But again, in terns of total dollars of community lending and investments. the likely effect of the exemption would not be major Thus. such an exemption might respond to much of the concern about paperwork without undermining the force of the CRA.

Lack of Incentives

Financial institutions complain about the lack of incentives for outstanding performance, noting that even a superior CRA rating offers no protection from a protest Ideally, of course, good performance should bring its own rewards—new business and enhanced public relations. But after assessing what it might cost to be rated outstanding. some institutions believe the payoff is not worth the extra effort under current law.

Various ideas have been proposed for adding statutory ''carrots'' to the CRA to increase the incentives. including a ''safe harbor.'' A safe harbor might limit formal protests against applications, for instance, except when the evidence of a CRA performance problem is substantial and specific.

The state of New York is taking public comment on establishing a safe harbor in the application process. A bank with an outstanding rating on its three most recent CRA examinations would be assured that its CRA performance would not bar application approval. The theory is that such a scheme would encourage banks to make the CRA a part of their overall. day-to-day business plans They would strive for outstanding performance and not view the CRA primarily in the context of applications. The Banking Department acknowledges that a safe harbor might be perceived as reducing community groups' involvement in the CRA. But state officials believe that if public comment were part of CRA examinations and not limited to the application context. its influence could be greatly enhanced

The Congress has taken a first step in providing incentives. Under the Bank Enterprise Act of 1991. insured depository institutions that do business in economically distressed communities can earn assessment credits for application against their deposit insurance premiums.[20]

CONCLUSION

From modest beginnings and minimal legislative review, the CRA has grown in national importance. At the same time. the vague nature of the act has bedeviled its implementation through the years. In essence, instead of imposing hard and fast rules, the statute relies on individual institutions and their local communities to define credit needs, with the expectation that the agencies will encourage this process and assess its success. To make up for the lack of precision, the agencies charged with enforcing the CRA have sought to measure CRA performance in a fair and comprehensive manner and to provide increasing guidance while avoiding any appearance of credit allocation.

Through a combination of efforts, the CRA has stimulated loans for home purchase. construction, and rehabilitation and for the development of small business and minority-owned business in low- and moderate-income areas. It has brought increased participation in public-private partnerships in urban and rural communities and has encouraged support for community development corporations and multibank lending consortiums that benefit low- and moderate-income communities. Indeed. many financial institutions have discovered that complying with the CRA helps them to compete for new customers and generate profitable business.

Although progress in community reinvestment marks the evolution of the CRA. unresolved problems remain and frustrations abound for financial institutions, supervisory agencies. and the public. In many cases, the major source of frustration rests on the law's lack of specificity. Yet that very lack also may be the law's most important strength While providing strong incentives for institutions to reach out to their entire communities. it leaves the question of "how" largely in the hands of the institution and its community. In so doing, it continues to encourage and produce important reinvestment efforts throughout the nation. ❐

[20] 12 U.S.C.A §1834 (supp 1992). The Congress has provided funds for establishing a Comrnunity Enterprise Assessment Credit Board. Which will create the guidelines for qualifying activities. The program cannot be implemented, howener, until additional money is appropriated to fund the assessment credits.

Section IV
Federal Reserve System

B A C K G R O U N D   I N F O R M A T I O N

Federal Reserve System

The Federal Reserve System, often called the Fed, is our nation's central bank. Created by Congress in 1913, it became the federal government agency responsible for monetary policy - influencing the supply and cost of money. The Fed also supervises banking organizations and provides services to financial institutions. These tasks, carried out by the Board of Governors and the twelve regional Federal Reserve Banks, help provide a growing economy with stable prices and a sound and flexible banking system.

Board Of Governors

The Board of Governors, located in Washington, D.C., is the Fed's central coordinating body. Its primary function is the formulation of monetary policy, but the Board also has supervisory and regulatory responsibilities over the activities of banking organizations and Pederal Reserve Banks.

The Board is comprised of seven members who are appointed by the President and confirmed by the Senate. The full term of a Board member is fourteen years, and the seven terms are arranged so that one expires in every even-numbered year. From among the seven Board members, the President names, subject to Senate confirmation, the Board's chairman and vice chairman to four-year terms.

Current Fed Board Members	Term Expires
Alan Greenspan, Chairman	January 31, 2006
Lawrence Lindsey	January 31, 2000
Wayne D. Angell	January 31,1994
David W. Mullins, Jr.	January 31, 1996
Edward W. Kelley, Jr.	January 31, 2004
John P. LaWare	January 31, 2002
Susan Meredith Phillips	January 31,1998

Federal Reserve Banks

To carry out the functions of the Fed, the country has been divided into 12 districts, each served by a Federal Reserve Bank. Some important Reserve Bank services are check clearing, electronic funds transfer, providing currency and coin, examining banks, processing bank holding company applications, lending to financial institutions, and acting as fiscal agent for the U.S. Treasury.

Reserve Banks are federally chartered corporations whose stockholders are their district's national banks and state chartered banks that are members of the Federal Reserve System. Separate nine-member boards of directors Govern each of these 12 banks. A Reserve Bank's stockholders elect six of the directors, and the Board of Governors appoint the other three. Directors appoint the Reserve Bank president (the chief executive officer) and the first vice president (the chief administrative officer) to five-year terms, subject to the Board of Governors' approval.

Monetary Policy

The Board of Governors and the reserve banks have responsibility for open market operations - the Fed's primary monetary policy tool. Through the buying and selling of U.S. Government securities, the Fed influences bank reserves. Other things remaining equal, a purchase of government securities by the Fed adds reserves to the commercial banking system, enabling banks to expand their lending and investing. Conversely, the sale of securities by the Federal Reserve withdraws reserves from the banking system.

Open market operations are the responsibility of the Federal Open Market Committee, often called the FOMC. It is composed of the seven members of the Board of Governors and five of the reserve bank presidents. The president of the Federal Reserve Bank of New York serves on a continuous basis; the presidents of the other reserve banks serve on a rotating basis. The FOMC, which Congress established in 1935, is required to meet in Washington, D.C., at least four times a year. Typically, it meets once every five to eight weeks.

The Board of Governors and the reserve banks also share responsibility for setting the discount rate—another important monetary policy tool. It is the rate financial institutions pay to borrow from the Fed for temporary, emergency, or seasonal purposes. By raising or lowering the discount rate, the Fed influences the cost and availability of bank reserves. The discount rate is set by the directors of each reserve bank every two weeks, subject to determination and review by the Board of Governors. The discount rate, as of November 15, is 3 percent.

Often Asked Questions About the Fed

The unique structure of the Fed often raises three questions:

1. Who owns the Fed?

Although Fed member banks own stock in reserve banks, their ownership rights are restricted. If the Federal Reserve Banks were to be liquidated and their assets sold, Fed member banks would only receive back what they paid for their stock. The value of the Fed's stock over and above that would be returned to the U.S. Treasury.

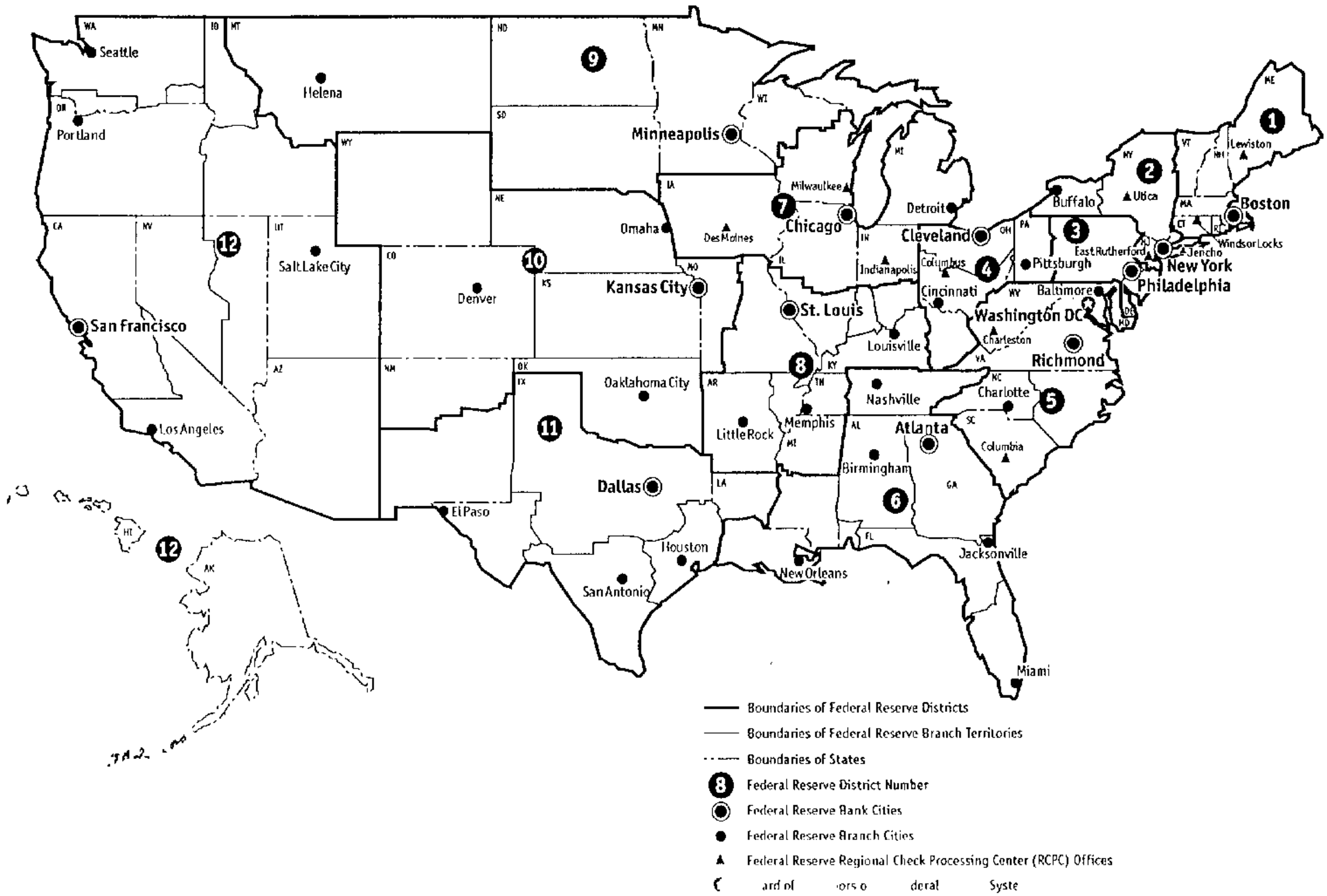
2. Where does the Fed receive its income?

Most of the Fed's earnings come from its portfolio of U.S. Government securities. The interest on them, for example accounted for most of the Fed's $20 billion revenues in 1992. From its revenues the Fed pays its expenses and a 6 percent statutory dividend on its member banks stock. The remainder is returned to the U.S. Treasury. In 1992, for example, the Fed paid $16.774 billion to the U.S. Treasury. Since 1914, the Fed has paid more than $290 billion to the U.S. Treasury.

3. Since the Fed has considerable discretion in carrying out is responsibilities, to whom is it accountable?

To ensure financial accountability, reserve banks are audited by the Board of Governors, which in turn, is audited by a private accounting firm. Also, the General Accounting Office (GAO) can audit selected Fed operations.

The Fed's ultimate accountability is to Congress which at any time can amend the Federal Reserve Act Legislation requires the Fed to report annually on its activities to the Speaker of the House of Representatives, and twice a year to the Banking Committees of Congress on its plans for monetary policy. The Fed also testifies before Congress when requested.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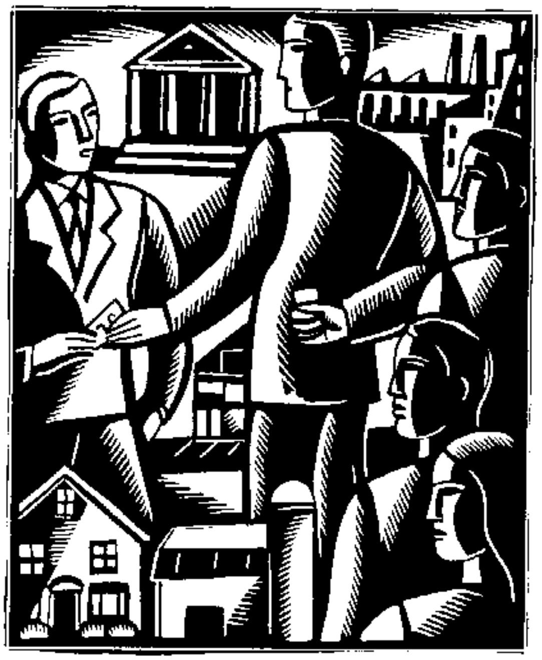
Windsor Locks
Boston
Lewiston
Boundaries of Federal Reserve Districts
Boundaries of Federal Reserve Branch Territories
Boundaries of States
Federal Reserve District Number
Federal Reserve Bank Cities
Federal Reserve Branch Cities
Federal Reserve Regional Check Processing Center (RCPC) Offices

Section V
Glossary/Bibliography



Glossary

anti-trust - term referring to legislation that controls the growth of market power exercised by firms. Not only does anti-trust refer to anti-monopoly policy, but also to restrictive practices operated by individual firms, groups of amalgamated companies (trusts) and groups of cooperating firms (cartels).

bank - an establishment that performs one or more of the following functions: accepting custody of money, lending money, extending credit, issuing currency, facilitating the transfer of funds by checks, drafts, bills of exchange or other instruments of credit.

Bank Holding Companies Act - regulation that requires all organizations that substantially control the management of one or more banks to register with the Federal Reserve.

bank holding companies - companies that hold at least 40% of their investments in banks.

CDC- community development corporations. Wholly owned subsidiaries of banks that are allowed to participate in activities forbidden to banks such as own, develop and manage real estate.

conventional mortgage - a mortgage loan that is neither insured by the FHA nor guaranteed by the VA.

credit - a promise to pay in the future in order to buy or borrow in the present. Time given for payment for goods or services sold on trust.

CRA - Community Reinvestment Act of 1977. Financial institutions must serve "the convenience and needs" of the communities in which they are chartered to do business by extending credit in these communities.

delineate - to indicate by drawing lines, to describe in complete detail.

discrimination - to make a difference in treatment or favor on a basis other than individual merit.

Equal Credit Opportunity Act of 1974 - promotion of the availability of credit without regard to race, color, religion, national origin, sex, marital status, age, receipt of public assistance funds or the exercise of any right under the Consumer Credit Protection Act

Fannie Mae - Federal National Mortgage Association. A government-sponsored private corporation operating to supplement private mortgage funds by providing a secondary market for FHA, VA and conventional home mortgages.

Fair Housing Act - 1968. The Act states that is unlawful for any person who engages in real estate lending to discriminate.

FFIEC - Federal Financial Institutions Examination Council. Regulatory committee comprised of the Federal Reserve Board, Office of the Comptroller of the Currency, Office of Thrift Supervision and the Federal Deposit Insurance Corporation.

FDIC - Federal Deposit Insurance Corporation. A federal agency organized in 1933 to guarantee funds on deposit in member banks. The FDIC also performs functions such as making loans or buying assets from member banks to help effect mergers, or helping to prevent bank failures.

FHA - Federal Housing Administration. A division of the Department of Housing and Urban Development. Its main activity is to insure residential mortgage loans made by private lenders and set standards for construction and underwriting.

FIRREA - Financial Institutions Reform, Recovery and Enforcement Act, 1989. This law requires that the financial regulatory agencies evaluate institutions' CRA performance using a four-tiered rating system, and that these ratings and a written evaluation of each institutions' CRA performance be disclosed to the public.

Freddie Mac - Federal Home Loan Mortgage Corporation (FHLMC). A private corporation authorized by Congress to sell participation sales certificates secured by pools of conventional mortgage loans, their principal and interest guaranteed by the federal government through the FHLMC.

HMDA - Home Mortgage Disclosure Act. Financial institutions must record information on all home purchase and home improvement loan applications including: the disposition of all such applications; applicant and borrower data on the race or national origin, gender, and income; and reasons for application denials.

HMDA data - Home Mortgage Disclosure Act data highlights the relationship between race, income and mortgage lending.

HUD - the Department of Housing and Urban Development. It is responsible for the implementation and administration of government housing and urban development programs.

interest - price paid for the use of money over time.

loan-to-deposit ratio - the ratio of loans a bank makes over the deposits the bank receives.

market failure - the inability of an unregulated market to achieve, in all circumstances, allocative efficiency where all resources are distributed to the most efficient firms and households. mortgage - loan in which property is designated as security for payment.

mortgage - loan in which property is designated as security for payment.

OCC - Office of the Comptroller of the Currency. The office within the U.S. Treasury Department having the responsibility for overall supervision and examination of national banks.

Office of Thrift Supervision - formerly the Pederal Home Loan Bank Board. Oversight agency for a system of twelve regional banks established by the Federal Home Loan Bank Act of 1934 to provide credit to member institutions.

primary market - the demand for original issues of a security. This contrasts with the secondary market where seasoned issues are traded.

redlining - the practice of denying credit in low-income, often predominant black or Hispanic neighborhoods.

Sallie Mae - Student Loan Marketing Association. This agency created a secondary market in guaranteeing student loans.

SBA - Small Business Administration. An independent agency, created by the U.S. government in 1953, for the purpose of helping small businesses compete with larger corporations. The SBA makes loans directly or guarantees loans made to small businesses.

secondary mortgage markets - an unorganized market where existing mortgages are bought and sold. It contrasts with the primary mortgage market where mortgages originate.

social costs - includes costs borne by the producer and any costs borne indirectly by other members of society, when facing problems such as pollution, congestion or lack of quality housing.

thrift - a name given to those financial institutions whose primary function is accepting time deposits and granting long-term mortgage loans. Generally these institutions are known as savings and loans or mutual savings banks.

trust- a combination of firms or corporations for the purpose of reducing competition and controlling prices throughout a business or industry.

underwriting policies - guidelines in which a bank or insurer will accept financial responsibility for a loan.

VA - Veterans Administration. An independent agency of the federal government established in 1944 to administer a variety of benefit programs for veterans.

Veterans Administration loans - Loaned funds, guaranteed by the Veteran's Administration. These are usually housing and education loans.

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